10 Minutes
on the OECD's BEPS project

pwc

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More than a tax issue: why BEPS will change the way you operate

Inside this issue

The OECD's[1] base erosion and profit shifting (BEPS) project is likely to spur the most significant changes to the taxation of international business since 1986. These changes will require you to reconsider where to invest and how to structure your global business operations.

The issue is political—governments facing budget shortfalls and various other public voices (e.g., the EU and non-governmental organizations) are questioning whether multinational companies pay their 'fair share' of taxes. And it carries reputational risks (particularly for consumer businesses)—companies with tax liabilities in a given country that don't readily correlate with the level of operations in that country are being subjected to aggressive income tax examinations and mainstream media attacks. This is occurring regardless that the taxes paid satisfy existing international tax rules, and may have been approved by the relevant tax authorities.

In response, the OECD has executed a multi-step plan (sponsored by the G-20 governments) to reshape international tax rules for countries to implement. Some countries are already using ideas considered in the BEPS project in tax audits or have changed their tax laws in a manner inconsistent with current rules. These actions conflict with the OECD's goal—a set of coordinated international tax rules that facilitates global trade— and highlight that different countries may not act consistently, producing an even more complex global tax picture. The result is additional tax uncertainty for companies, with significantly increased risk of double taxation, protracted cross-border disputes, and inadequate procedures for intergovernmental dispute resolution.

Over the next several years, BEPS-related law changes likely will cause your company to see upward pressure on effective tax rates and cash tax outlays. You should start preparing now, if you haven't already.

The quick take

1. **Who is most affected by this issue?**
   Multinational companies may see an increased tax burden around the world, and there's a strong likelihood that rule changes will affect the optimal structure for your global operations. The countries directly involved in the OECD BEPS project make up over 84% of the total world economy.[2]

2. **What's the timeframe for taking action?**
   While the OECD BEPS project only finalized its recommendations in October 2015, some countries have already begun implementing changes to their tax systems. Companies will need to begin assessing the impact on business operations now.

3. **What's the most surprising takeaway?**
   New reporting requirements for larger companies will make detailed country-by-country tax and financial information visible to many eyes, and possibly (in the future) not just those of tax authorities. In addition, the volume of data disclosed will be much more than companies are currently reporting worldwide, so your compliance burden will likely grow substantially.

1 Organisation for Economic Cooperation and Development.

2 PwC National Economics and Statistics analysis.

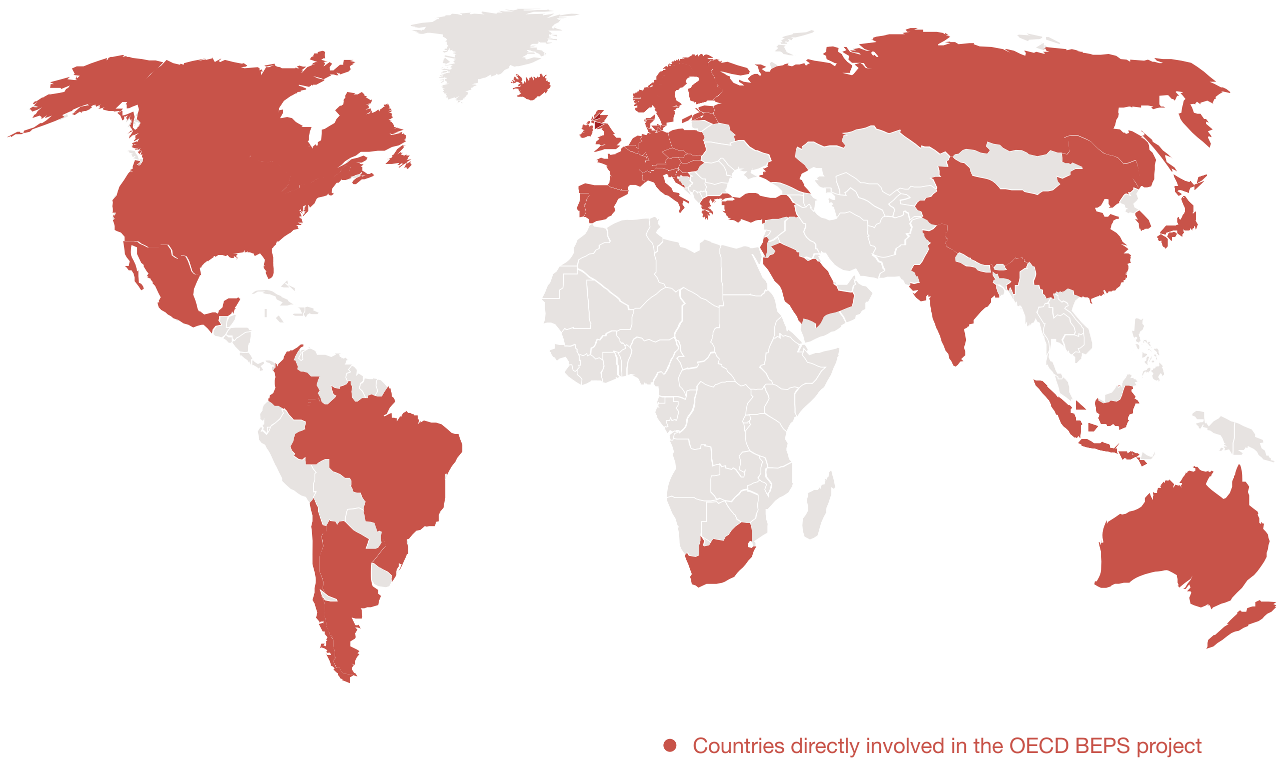
At a glance

BEPS-related rule changes are happening. Who is driving them?

The OECD BEPS project seeks to update international tax rules in a coordinated way. The OECD has organized the project's 15 focus areas into five basic groups that address the following:

- Coherence—challenges to the integrity of individual countries' income tax systems
- Substance—tax arrangements formally involving more than one country
- Transparency—tax reporting and disclosure
- The digital economy
- A multilateral treaty to implement certain BEPS recommendations

While global coordination is the goal, the project spurred some jurisdictions to take action before the project was completed, including increased tax audits, high-profile investigations, and even significant law changes, without regard to any consensus the project might reach.



01

What the OECD's latest tax project means for your business

CEOs weigh in globally about tax issues

70%
are concerned about increasing tax burdens.

67%
say that an internationally competitive and efficient tax system should be a top government priority.

54%
say the government of their jurisdiction has not been effective in creating an internationally competitive and efficient tax system.

53%
say governments on a global basis are increasingly implementing more competitive tax policies, which influence organizations' decisions on where to operate.

Base: 1,322
Source: PwC, *18th Annual Global CEO Survey,* January 2015

Tax considerations are always a factor in business planning. The OECD BEPS project may have a significant impact on your company's financial results. Operational arrangements that have worked well up to now may cease to be economically viable.

Transaction flows

Intercompany transactions, including sales, loans, and licenses, play a significant role in multinationals' global operations. The BEPS project is focusing attention on the nature of those transactions, modifying rules on the value attributed to them and the types of arrangements that will be respected. For example, many companies use 'hybrid' transactions, involving companies or instruments that are treated differently in different tax jurisdictions, often resulting in tax efficiencies. These hybrids will likely be subject to more restrictive treatment by some jurisdictions in the future, which may result in double taxation or otherwise affect the profitability of certain transaction flows.

Tax incentives

With economic growth and social objectives in mind, some countries provide tax incentives that encourage companies to invest or structure their operations in particular ways. For example, some countries provide preferential tax treatment for manufacturing operations or activities involving intellectual property (IP). The OECD has proposed to limit or eliminate tax regimes that are seen as harming other countries' tax bases. This could affect the profitability of some operations.

Taxing the supply chain

Today, different countries' approaches for taxing the supply chain vary widely. In general, despite an increasingly digital business environment worldwide, the OECD's recommendations for rule changes emphasize the importance of allocating profit to locations where you have 'substance,' including tangible assets and people actively performing business operations. For example, companies that merely hold ownership of valuable IP may not be viewed as creating value if the company has no people managing that IP. This approach could cause a shift in where and how some of your income is taxed, reducing overall global profitability.

In general, there are likely to be more limits on business planning that takes tax considerations into account.

02

How the BEPS project is changing the tax rules

One project, many outcomes, different timetables

Your company may need to consider overlapping, and possibly inconsistent, rules that will continue to evolve.

Some countries adopted BEPS-related measures before the project was complete.

Now that the recommendations have been finalized, the OECD will focus on how they are adopted around the world.

Some countries will act swiftly, while the legislative process may take time in others (like the US).

Other organizations may also act on the same issues. The EU has already created new tax rules its member states must apply, and has been aggressively using its anti-abuse rules to challenge some member states' tax incentives.

The OECD has now issued final BEPS reports with recommendations on 15 topics.

Final reports proposing specific rule changes

Several of the OECD's BEPS final reports that propose specific changes to international tax rules involve transfer pricing. Companies apply transfer pricing rules to allocate value among the entities, assets, and activities in their supply chain. Transfer pricing is a key component of the international tax framework and tax compliance. The OECD considers that some companies allocate too much value to low-tax countries where they do not have many personnel and too little value to countries where they produce or sell commodities or manufactured goods. Transfer pricing areas addressed by the BEPS project include intangibles (intellectual property), risk, commodities, low value-adding services (e.g., back-office functions), and documentation, including 'country-by-country reporting.' The OECD's revisions to the transfer pricing rules rely on subjective terminology and appear to deviate from US domestic transfer pricing rules—both of which may lead to increased controversy and double taxation.

Other reports propose rule changes addressing 'hybrid' tax arrangements, tax treaties, and the deductibility of intercompany payments such as interest. Mechanisms that can be used to simplify tax arrangements may be viewed in some cases as inappropriately reducing taxable income.

Another report expands the treaty-based concept of a company's 'permanent establishment' (basically, taxable nexus) in a country. The expanded scope will result in more business operations being subject to local-country income taxes.

Other final reports

Final reports that don't involve specific tax rules could still have longer-term effects. One set of papers recommends changing countries' tax incentives (particularly for IP) that are viewed as 'harmful' tax practices. Another set relates to taxing digital commerce, with no immediate recommendations beyond the application of value-added taxes. A third set involves a proposed multilateral global tax treaty that can require enforcement of certain OECD BEPS recommendations. Other reports also suggest ways of requiring taxpayers to disclose 'aggressive tax planning' and of strengthening rules for controlled foreign corporations. Finally, another report offers ideas for improving tax dispute resolution mechanisms between countries, which likely will be heavily used as different countries adopt the OECD recommendations differently.

03

Expanded reporting brings complexity and competitive questions

What you will be asked to disclose

The three-tiered reporting approach will kick in for fiscal year 2016:

Country-by-country report
Details on each entity, organized by country; data to include revenues, profits, taxes, assets, employee numbers and costs, capital, accumulated earnings, and intercompany payments, filed in the headquarters jurisdiction.

Master file
Standardized information for all group members: global organizational structure; description of business; IP development, use, and transfers; intercompany financial arrangements; and financial and tax positions, filed in each country with operations.

Local file
Transaction details between local entities and affiliates, such as the local management team, business strategy, and restructurings or IP transfers, filed in each country with operations.

Starting with companies' fiscal year 2016 results, multinationals having global revenues of USD 849 million or more will face new tax reporting requirements requesting information intended to provide a risk assessment tool for tax authorities. Many companies will not have the people or systems in place to efficiently gather, organize, and document all of the necessary data.

These rule changes will ultimately require annual reporting to tax authorities at three levels. The first element (which taxpayers will generally need to provide for fiscal 2016) is a 'country-by-country report' that gives a detailed picture of business results for each country where you operate (including things like number of employees, revenues, pre-tax profit, and taxes paid). Your company will also need to give an overall picture of its global business, aggregating data from all of the countries where you operate. In addition, your company will be required to report separately to each country where you operate with business and tax information about the local entities and operations in that country.

Increased scrutiny and disputes

The disclosure of your business information will be accessible—through automatic information exchanges—to tax authorities wherever you have a presence (subject to certain conditions still in process). You will need to consider how to explain clearly to tax authorities the operational purpose of business arrangements that may include tax advantages.

BEPS-related rule changes may also result in new requirements for reporting taxable income. Local country rules adopting OECD recommendations could call for the reallocation of profits so that income is aligned with locations where you have personnel. This may not align with where your capital is invested. As the rules change, tax authorities may differ on their views about where to report profits. More intensive tax audits and protracted disputes could result, straining your tax department's resources. As this escalation may occur in many countries, companies may be dealing with multiple, ongoing disputes.

While only tax authorities should receive your sensitive business information, there are concerns that it potentially could be disclosed to others, including the general public and business competitors. This could result in additional public attention to your business arrangements or rival companies using your information to their advantage.

04

Four ways to prepare for BEPS-driven rule changes

Key concerns include

1. Likelihood of higher tax burdens and compliance requirements.
2. Increased risk of double taxation on certain income.
3. Likelihood of more tax disputes arising in more countries.
4. Possibility of confidential business data being more widely visible.
5. Greater uncertainty and unpredictability in the global tax environment generally.

While the OECD's BEPS recommendations have been largely completed in 2015, the process of adopting them in countries' tax rules has just begun. Their repercussions for your business will continue to evolve, and you should start preparing now, if you have not already.

1. **Take a fresh look at your company's operational and tax footprint.** BEPS-related rule changes likely will result in higher tax burdens and reduced profitability. Reducing risks of double taxation may require significant operational shifts. This situation could prompt companies to examine their global footprints and cost structures in light of changing growth and profitability goals. You may find that current corporate structures, intercompany flows, and business processes reflect outdated priorities.

2. **Make adjustments before earnings are affected.** Global business planning should have flexibility to accommodate various BEPS-driven rule changes over the coming years. You'll need strategic thinking to best position your company for high performance and superior shareholder return. It's important to coordinate tax planning, treasury arrangements, and operations.

3. **Check your systems preparedness for increased compliance obligations and disputes.** You'll want to check whether global tax reporting systems and personnel can handle greatly increased levels of data and reporting. Better global tax coordination for multinationals will require well-organized document management, data, and workflow systems to increase collaboration across tax, finance, and geographies.

   Aggressive tax audits and dispute resolution in multiple countries may require additional company resources. Implementation of the OECD recommendations in local country domestic rules will likely be inconsistent and may create more cross-border tax disputes. In addition, your financial reporting function will likely need tax department help to understand the financial statement impact of BEPS-related rule changes. And, beyond complying with the new rules, there are considerations regarding public perception of your company's tax arrangements and the potential impact on your company's brand.

4. **Stay current and share your views.** BEPS developments—and some countries' responses—are moving fast. Know what is happening in each jurisdiction where you operate. Several substantive items from the BEPS project remain to be wrapped up in 2016, and there is a second phase of the project regarding implementation and monitoring. There are still opportunities to provide the OECD and governments in key jurisdictions (including the EU) with your views on issues they are addressing. Participate in the discussion now, whether as an individual company or through membership in business organizations.

If you have more than 10 minutes

Learn more about what this means for your own organization

The final reports are summarized in this article: "***Multinationals receive OECD recommendations on BEPS for G20 and wider takeup.***" Better understand the current hot topics and discussions related to recent BEPS developments by exploring a couple of articles about transfer pricing documentation and country-by-country reporting, which can be found within ***TP Perspectives***.

Additional hot topics related to BEPS include interest expense deduction limitations, permanent establishment rules, and the use of 'hybrid' entities. Learn more about these topics by reading these articles: "***Revamped dependent agent rule a marked change in the OECD's final BEPS permanent establishment report,***" "***OECD issues final report with recommendations on a best practice approach to interest limitation rules (BEPS Action 4),***" and "***Final OECD hybrids report creates more complexity and may affect investment decisions.***"

Explore related reading

Find the latest updates, resources, and content related to BEPS online: ***BEPS site, US Transfer Pricing***, and ***US International Tax Services***.

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How PwC can help

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