INTRODUCTION

On Tuesday 16 September 2014 the international community stepped up the fight against tax avoidance as the OECD presented detailed recommendations for changes in global tax laws. The proposed changes are included within the first seven deliverables from the OECD’s Base Erosion and Profit Shifting (BEPS) Project. The process of agreeing recommendations has involved members of the G20, the OECD and developing countries.

Therefore, it is not surprising that the recommendations are receiving huge attention around the world. Large multinational companies will be impacted by the foreseen changes and have been actively involved in the consultation process. FTI Consulting provides an overview of the recommendations and considers the broader picture and the political implications in some of the key economies.

The OECD Recommendations

The OECD has delivered clear and specific materials in relation to:

- Neutralising the effects of hybrid mismatches
- Transfer pricing documentation and Country-by-Country reporting
- Preventing treaty abuse; and
- Transfer pricing aspects of intangibles.

The remaining reports provide valuable updates and insights. Particularly important is the conclusion that a multilateral instrument (to have the same effect as a simultaneous renegotiation of multiple bi-lateral treaties) is both feasible and desirable. The mandate for negotiating that instrument now move forward.

The conclusion of the report on the digital economy (Action 1), that it is not possible to “ring-fence” the digital economy comes as no surprise. The specific facets that exacerbate the BEPS risks will be addressed in delivering other Action Plan items. The VAT focus is noteworthy given the EU influence on this tax.

The report on harmful tax practices focusses on “substantial activities” and transparency. There are evident tensions around substantial activity and incentive regimes. However, progress is being made and there is a detailed agreed framework on transparency with spontaneous information exchange on tax-payer specific rulings related to preferential regimes. This framework is intended to start applying following the Forum on Harmful Tax Practices’ autumn meeting.

Generally there is the view that transparency and availability of information will limit opportunities for unacceptable tax practices. However, this will require tax authorities to understand and appropriately action the material that they receive.

The concrete measures

In relation to hybrid mismatches, the proposal is to tackle this through domestic legislation with related treaty provisions to address transparency, dual residency, and the interaction with the domestic rules. The rules are linked and ordered enabling them to address a range of scenarios including where one jurisdiction has not implemented them. The primary rule looks to deny a deduction. The provisions will apply for controlled groups and between related parties (which will have a 25% investment threshold). Issues remain including on implementation and areas such as the interaction with CFC regimes, on-market repos and intragroup regulatory capital. However, we now have the framework for domestic legislation and the treaty amendments. These changes will impact, amongst other things, on some widely implemented financing structures.

In relation to country-by-country reporting, the OECD has provided details of what will be required. It has been stated more than once that this is primarily a risk assessment tool for tax authorities. We also have details of the new transfer pricing documentation requirements (in the Master File and the Local File). However, significant issues on implementation remain to be addressed over the coming months.

In relation to the prevention of treaty abuse, clarification on the purpose of the treaty should be included in the treaty and a minimum level of protection by way of anti-abuse provisions should be included (limitations on benefits and/or an anti-abuse rules based on a principal purposes test). In addition policy matters should be taken into account when considering whether to enter into a treaty.

In relation to transfer pricing of intangibles, the Transfer Pricing Guidelines will be expanded (in Chapters I and VI) and interim guidance has been provided on the allocation of returns (with legal ownership and contractual arrangements providing the starting point). There is further work to do on some difficult areas.

Some of the more complex issues remain across the Action Plan and deliverables. This includes implementation generally; the interaction of the proposals; and specific categories of transaction, taxpayer and holding structures. It is also interesting to reflect on the focus on the interaction of domestic and treaty provisions given the continuing issues that
we see in the VAT arena (i.e. the recent ECJ decision in GMAC UK plc).

However, we now have provisions and guidance that businesses can review and consider in their specific circumstances. The OECD has delivered a palpable change in the international tax environment.

The international context/G20

The focus on tax has come as a by-product of the financial and economic crisis with increased pressure at national and international level. NGOs also became increasingly active in this area and are very present on international platforms such as the OECD, claiming that tax avoidance by multinational companies is costing poor countries billions of Dollars.

In 2013, the G20 decided that an action plan needed to be developed to ensure coherence, substance and transparency of the international tax system. The BEPS Action plan is reviewing 15 specific items over a two year period and working in collaboration with national governments, developing countries as well as stakeholders’ input through public consultations. The process has been wide-reaching, involving 44 countries representing 90% of the world’s economy and more than 80 developing countries.

It will be important to track how the international political scene will be influenced in the coming months with the changes taking place at the European and national stages.

Views from Brussels

In the past years tax avoidance has become a hot topic in Brussels. Many of the Member States use tax incentives to attract business which has prompted the European Commission to start investigations against a number of Member States. The debate on the patent box regime and the confidential discussions in the Code of Conduct group illustrate how sensitive the issue is.

The change in Commission has increased the debate and scrutiny on tax evasion. Despite the European Commission not having direct authority over national tax systems, one of the first key areas President-elect Juncker asked his Competition Commissioner-designate, Margrethe Vestager to explicitly focus on is fighting tax evasion. In addition, Pierre Moscovici, the Commissioner-designate for the Economic and Financial Affairs, Taxation and Customs portfolio, was also specifically asked to continue the fight against tax fraud, tax evasion and aggressive tax planning, as well as tackling base erosion and profit shifting, including in the digital economy.

The current Commission, meanwhile, is using the sharp sword of competition policy to tackle tax avoidance. In June 2014 the Commission opened three in-depth investigations to examine whether decisions by tax authorities in Ireland, the Netherlands and Luxembourg with regard to the corporate income tax to be paid by Apple, Starbucks and Fiat Finance and Trade, respectively, comply with the EU rules on state aid. This confirms the recent trend of European political and public frustration with regard to some large multinationals, and EU Competition Commissioner Almunia stressed in June that these investigations were only a first step and that a broader action plan was considered to pursue ‘aggressive’ tax avoidance.

Between 29 September 2014 and 7 October 2014, the Commissioners-designate will face scrutiny during their hearings in the European Parliament, where MEPs will question them not only on their capabilities to fulfil their role, but also on their areas of focus for the coming five years. As a taste of things to come, it is interesting to note that in some written questions already provided by the European Parliament to the Commissioners-designate, Moscovici was not only asked what further measures he envisages to enforce and effectively implement the Action Plan to strengthen the fight against tax fraud, evasion and money laundering, as well as the recommendations on aggressive tax planning and on tax havens; but he is also asked how he will ensure a consistent, EU-wide approach between Member States and his views on the need for convergence of tax systems in the EU. All this sets the scene for a strong scrutiny in the coming months by the European institutions and an increased pressure from the broader European political scene.

Views from the UK

With all eyes riveted on Edinburgh and Glasgow, London has been more muted in reacting to the OECD proposals. A keen supporter of global tax reform, Chancellor George Osborne noted that “international cooperation is the only way to tackle the challenge of tax avoidance in the global economy” when outlining the UK priorities for the G20-OECD project for countering BEPS in March 2014. Keen to protect its financial sector and the “Patent Box” regime it introduced in 2013 to become a favoured destination for pharmaceuticals and research development industries, London may be cautious in espousing sweeping global tax commitments which would jeopardise either of them. However, in the wake of the various scandals involving leading US companies operating in the UK from a Luxembourg base of operations, politicians on both sides of the aisle will be keen to take a tough stance on tax optimisation as they have done on the benches of the Public Accounts Committee when grilling company representatives. The UK Government is particularly keen to avoid being criticised by the Opposition for letting big business ‘off the hook’ while forcing through public sector cuts. Some on the left of the Labour party are adept at making political noise about ‘big business’ and have quietly influenced the party’s policy discussions on tax and wealth.

Views from France

In Paris, it’s all applause for the OECD report conducted by the team of Pascal Saint-Amans, the Frenchman at the helm of the OECD’s Centre for Tax Policy and Administration. Tightening the screws on tax avoidance has been a priority of the French government under this administration as well as the last. In October 2013, a substantial parliamentary report on tax havens had labelled the fiscal optimisation undertaken by
companies “the poison of modern democracies”. It estimated annual losses resulting from tax evasion to be between 60 and 80 billion euros. A month later, the French Parliament adopted sweeping legislation against fiscal evasion and “grave financial delinquency”. Over the years, Paris has been one of the most vocal proponents of the development of a European tax regime capable of ensuring taxes made in the EU – in particular in the digital sector – are taxed to the benefit of all Member States.

It is good to see the ‘entente cordiale’ alive and working where France is pushing an initiative whereby the UK as the largest digital economy in Europe is the biggest winner.

At a time of economic hardship the French government will be keen to push forward any opportunities which can benefit them financially. In the summer of 2013, the decision of TOTAL, the leading French international oil company to relocate its financial HQ to London caused a media firestorm. While unjustified - the move had no substantial taxation implications – the uproar testifies to the sensitivity of the subject. Any measure which will alleviate business relocations perceived to be the by-product of restrictive taxation environment will be welcome by Paris. Finally, some policymakers in Paris view the OECD framework as having the potential to spur a fairer environment capable of supporting a European digital sector which to date has struggled to compete with established American competitors.

Views from Germany

The German government estimates it is missing out on 160 billion euro per year because foreign companies can do business in the country without being legally obliged to pay the same tax rate on profits that their German counterparts are forced to pay. Therefore it is no surprise that Germany’s Finance Minister Wolfgang Schäuble of the Christian Democrats (CDU) is in full support of the Cairns agreement; in fact, he sees himself as a driving force behind the initiative, having pushed for it within the circle of G20 finance ministers for the better part of two years.

The bottom line for him is that companies should pay a fair share of taxes wherever they make profits. And although Berlin concedes that competition can be positive, even between governments and their respective tax regimes, there is a hope that the BEPS initiative will serve to prevent a further race to the bottom on tax rates (not only attractive for traditional tax havens, but, as German officials privately point out, partners such as Ireland and Luxemburg as well).

The German business community shows more scepticism, arguing that Schäuble cannot be so sure of financial gain with the initiative in place, because new players like China and India would demand their share of the cake. In addition, the opposition in Germany (or rather what is left of it in these days of a Grand Coalition), calls for international harmonization of tax rates, for once enjoying that they are not in government and thus do not have to implement it.

Views from the US

The OECD BEPS proposals were received with great trepidation from the US multinational community. The initial push for transparency through country-by-country reporting and transfer pricing documentation has companies worrying about how to comply, what will be done with the information and whether there will be a serious impact on competitiveness. There is also a concern that the OECD process is not familiar and that the path for constructive engagement with the OECD is unclear with respect to advocacy and influence over final rules.

While the US has lagged in reforming its tax code, the developed world has actively moved toward a competitive advantage by variously adopting territorial tax systems, lower tax rates and innovation incentives like patent box. Because the US continues with its worldwide tax system, there is greater pressure on US multinationals to manage the exposure of profits to taxation and the lack of mobility of capital through the use of aggressive tax planning and structures. The characterization of these activities as “tax avoidance” has, from the view of US MNCs and policy makers, been excessively focused on US brands including Apple, Google, Amazon and Starbucks and has been manifested in tax shaming throughout the world. The result is a strong feeling that the OECD is biased against US MNCs.

Furthering this feeling is the belief that because the US worldwide system allows for legal structures that perpetuate deferral, there is a reliance on form and compliance that may run counter to the OECD’s preference for “substance.” Given the lack of clarity on what constitutes substance, there is concern from US MNCs that the new rules could make life exceedingly difficult in a world that is already tilted against them. This is particularly true for industries like high tech, pharma and branded goods that are IP intensive. These players are actively educating US lawmakers on the detrimental impacts they expect from the OECD proposals and are pushing hard for comprehensive tax reform as the appropriate answer as opposed to adoption of the OECD recommendations in a vacuum.

Adding to the policy and political environment surrounding the tax reform discussion and the OECD release is the US focus on inversions and the Treasury’s September 22, 2014 release of a Notice detailing regulatory changes designed to slow the current wave of companies heading for the exits from the US to Europe. The tax avoidance issue has gained considerable steam in the US as the inversion trend has accelerated over the past year as more companies have embraced the realities of globalization and realized the benefits of redomiciling to more tax friendly jurisdictions to increase competitiveness, access foreign markets and consumers and improve the capital position for crossborder M&A activities.

The Obama Administration’s inversion proposals coupled with its support of the OECD package are a clear indicator that the threat of base erosion is a major driver of tax policy thinking in the White House and among Democrats in Congress. Against this backdrop, the OECD proposals have gained considerable media coverage and attention. The framing of the proposals as a response to such an unpopular strategy and the election-posturing by the President and Democrats adds a sense of
urgency and importance to these issues that is unlikely to go away soon.

That said, despite the enthusiasm from the Obama Administration for the OECD proposals at both the drafting table and in the G-20, we do not expect the US to enact the OECD reforms any time soon and remain sceptical that the US would adopt the package in its entirety. Republicans in Congress are opposed to the OECD approach and the Republican-controlled House of Representatives will not embrace the BEPS package. It is also clear that there will be no serious effort to consider the proposals apart from a broad tax reform of the US tax code. What is hoped is that the combination of the OECD moving forward with some countries ultimately adopting the new rules and the current “crisis” related to inversions, the timetable for tax reform will be expedited.

At the end of the day, US MNCs will be in limbo as the US stumbles toward tax reform. As the rules change in various countries where US firms operate, they will inevitably face the mandate to comply with new rules that place them at a larger disadvantage and under more scrutiny. As such, companies should be working to develop their case for “substance” where they operate and begin building and strengthening relationships with key officials in jurisdictions where they operate. The OECD BEPS project will become a reality whether the US enacts the new rules or not. The focus of US MNCs will be to learn the new rules of the road, keep the target off their backs and leverage this most recent burden to make the case for US policy makers to reform the US tax code as soon as possible.

Next steps

On 20-21 September the G20 Finance Ministers met in Cairns, Australia and endorsed the finalised global Common Reporting Standard for automatic exchange of tax information which is seen as a step-change in the ability to fight tax evasion. With a number of key milestones coming up, including the G20 Summit in Brisbane on 15-16 November, businesses need to be prepared for change in the longer term.

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<tr>
<td>28-29 October</td>
<td>Global Forum on Transparency and Exchange of Information for Tax Purposes in Berlin</td>
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<td>2015</td>
<td>All action items relating to tax recommendations to be finalised and an overall package for an overall approach on BEPs will be delivered</td>
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The OECD tax reform recommendations

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