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BEPS goes global and local: What it means for operations in non-adopting markets

With more than 80 countries now having agreed to adopt at least the minimum elements of the Base Erosion and Profit Shifting (BEPS) Action Plan, there's no getting around BEPS. But partial or modified application in different local markets is creating an even more complex patchwork of requirements than before. A lack of sophisticated tax management capabilities can result in competing demands and a greater risk of tax disputes and double taxation that follows. So what are the complexities facing your business, why are the risks increasing and how can you manage the impact?

BEPS has been spearheaded by the Organisation for Economic Co-operation and Development (OECD). But backing from the G20 and strong support from many developing economies means its reach is much broader than the 34 members of the OECD.

Many non-OECD members including China, India, Brazil and South Africa were closely involved in the development of the Action Plan and are beginning to implement elements of it. Many non-G20 members were also involved, participating in the technical working groups and regional consultations.

A flurry of sign-ups in the first half of 2016 took the number of countries agreeing to introduce the minimum BEPS standards[1] including country-by-country (CbC) reporting beyond 80.[2] Recent sign-ups show a global spread: Egypt, Kenya, Nigeria, Pakistan, Singapore, China and Hong Kong. And the newcomers include a number of offshore centres such as Jersey, Guernsey and Lichtenstein. We know there will be more to add to the list in the coming months.

1 The minimum standards as set out in the 'inclusive framework for the implementation of the BEPS package' cover harmful tax practices, tax treaty abuse, country-by-country (CbC) reporting requirements for transfer pricing and improvements in cross-border tax dispute resolution.

2 OECD media release, 30 June 2016 (http://www.oecd.org/newsroom/first-meeting-of-the-new-inclusive-framework-to-tackle-base-erosion-and-profitshifting-marks-a-new-era-in-international-tax-co-operation.htm).

But there are still a number of significant markets outside the fold including Thailand, Malaysia, Panama and Mauritius. Thailand, Malaysia and Panama have engaged in the BEPS development and may get on board at some stage. India has re-negotiated its tax treaty with Mauritius, which includes a withdrawal of the capital gains exemption. While the treaty renegotiation had been under discussion for some time, the conclusion of the BEPS project seems to have encouraged India and Mauritius to finalise the new agreement.

Accelerating and simplifying implementation

The acceleration in take-up owes much to the OECD's introduction of an 'inclusive framework for the implementation of BEPS'. By focusing on the minimum rather than the broader recommended BEPS standards, the framework aims to encourage states to 'work collectively on an equal footing and in a co-ordinated manner to level the playing field'.[3]

To avoid renegotiating many bilateral treaties, the OECD is developing a multilateral instrument that would allow countries to easily add the BEPS tax-treaty recommendations into their agreements. More than 90 countries are involved in the development of the multilateral instrument and they're aiming to agree the terms by the end of the year.[4] Both the multilateral instrument mechanism and the international cooperation that underpins it have never been seen before. But there may be sticking points – for example, some countries including India are unlikely to accept a mandatory arbitration clause.

Action:
The widespread application of CbC reporting, one of the minimum requirements set out in the inclusive framework, will put strains on information gathering, evaluation and documentation. Upgrades in systems and governance procedures will almost certainly be needed, both locally and at group level. Look at how the information in the CbC report may be interpreted and used by tax authorities, and what risks this opens up for your business.

No shelter

What does this mean for businesses operating internationally? The growing application of BEPS in both developed and emerging markets worldwide means that it will impact on all firms with an annual turnover above the BEPS threshold (€750 million). And some countries are planning to set much lower qualifying thresholds for the reporting requirements – as low as
€45 million in Spain, €50 million in the Netherlands and €100 million in Germany.

The impact doesn't just stem from the fact that more countries are coming into the BEPS fold. The shift in transfer pricing rules mean that taxable income is likely to be distributed across many more jurisdictions than before. The Action Plan also extends the types and location of operations that could qualify as permanent establishments (PEs) for taxable purposes. Storage, delivery and even fly-in business could all now be deemed as PE operations. This would force your business to keep records, submit returns and pay tax in many more jurisdictions than before.

Action:
Build BEPS and variations in local application into strategic planning. This includes mapping operations against the changing tax rules, determining any new or increased tax exposures (eg the new PE designation) and judging what modification, relocation or more fundamental restructuring may be needed to manage these demands. While there will be differences from jurisdiction to jurisdiction, the broad sweep of BEPS is towards aligning tax liabilities with economic substance. This means that you can begin to plan ahead before the different national legislation is put in place and develop a reasonably consistent response across your organisation.

3 Implementing the BEPS Package: Building an inclusive framework, OECD, February 2016 (https://www.oecd.org/tax/flyer-implementing-the-bepspackage-building-an-inclusive-framework.pdf)
4 OECD media release, 31 May 2016 (http://www.oecd.org/tax/treaties/discussion-draft-beps-multilateral-instrument.htm)

Different directions

The new international tax landscape would be reasonably manageable if it were to result in a genuinely level playing field. But selective application and the different pace of implementation across various jurisdictions worldwide actually mean less certainty and consistency than before.

Some states such as the UK and Australia are applying most of the recommendations as well as the minimum standards. But the bulk of signatories, including most of those in emerging markets, are only focusing on the inclusive framework minimum for now. Even some of the recommended areas such as interest rate deductions on intra-company debt are open to wide local interpretation and variation. And to add to the complexity, some states are actually going further than the architects of BEPS envisaged. For example, India has introduced an equalisation levy on online advertising, company-to-company e-commerce and many other forms of digital business conducted by organisations with no PE in the country. This approach was considered but not recommended in the Action Plan.

The US has introduced CbC reporting for US-based multinational entities (MNEs) with more than $850 million in annual revenue, though this is probably as far as it will go in applying BEPS. While the US is involved in the development of the multilateral instrument on tax treaties, it's unlikely to sign the PE provisions because US MNEs are liable for tax on their global operations and receive credits for the tax they pay abroad. Given what is in effect a worldwide approach to taxation, the US would have little interest in creating more PEs elsewhere.

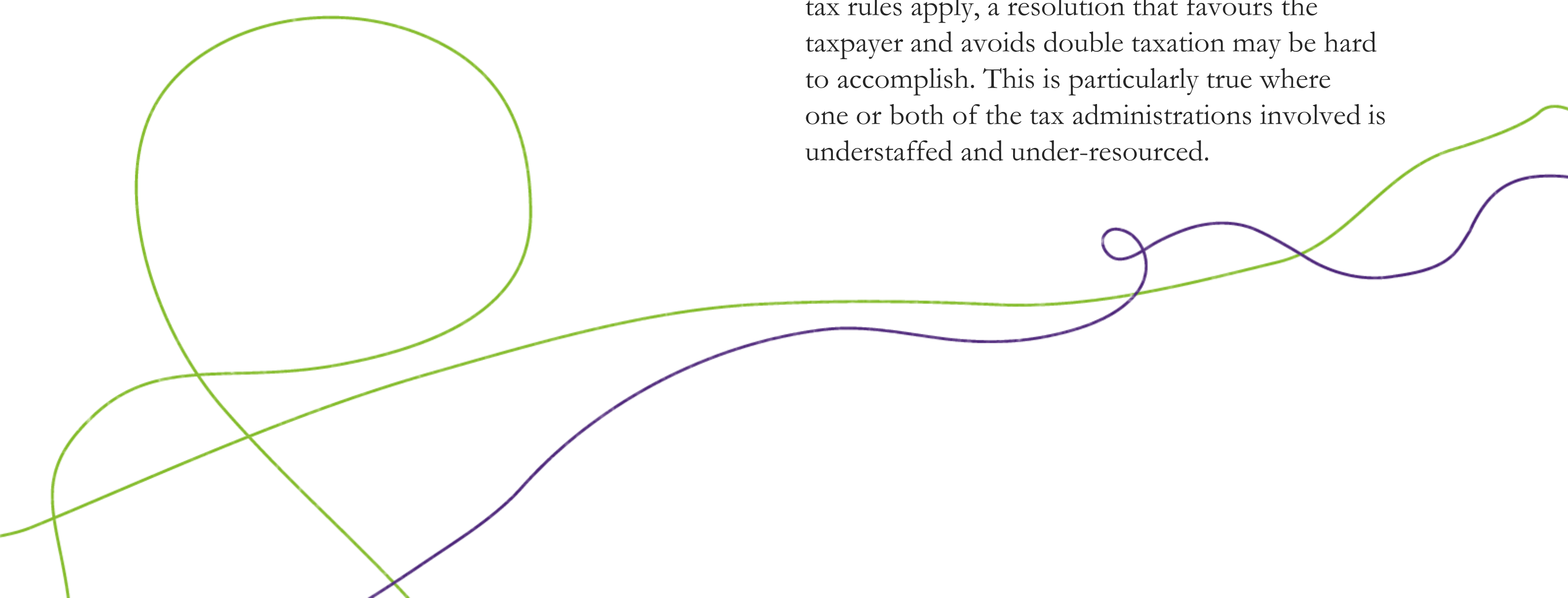
Over time, more of an international consensus could emerge, albeit with some countries such as the US continuing to go their own way. We're already beginning to see the emergence of regional tax blocs, within which there is a high degree of harmonisation in how BEPS is likely to be applied. This includes the EU and ASEAN. Many countries in Africa will follow the lead taken by South Africa, which is planning to introduce new transfer pricing policies that take their cue from BEPS. But some countries within these various blocs will still want to apply either more favourable or more stringent tax arrangements than others.

Action:
Build or hire in the capacity to monitor tax developments that are imminent in all the markets in which you operate and those that may eventually have an impact on your business. You can then begin to develop contingency plans.

Disparity heightens complexity

These different and possibly competing tax rules multiply the compliance demands. The extra burden will fall most heavily on mid-size MNEs, which tend to lack the well-developed capabilities needed to deal with the increased information gathering, record-keeping and reporting requirements.

Both the disparities in how BEPS is applied and the new information obtained from CbC reporting are also likely to heighten the risk of double taxation and disputes with tax authorities, with mid-size MNEs caught in the middle. Improvements in cross-border tax dispute resolution are one of the minimum requirements for countries signing up for the inclusive framework. But where different tax rules apply, a resolution that favours the taxpayer and avoids double taxation may be hard to accomplish. This is particularly true where one or both of the tax administrations involved is understaffed and under-resourced.



The lack of consistency also complicates the application of BEPS. One example is how the Action Plan seeks to shift the focus of taxation from where goods and services are produced to where they are consumed (the 'destination' of value creation). But many would argue that a destination tax is only viable if it's universally applied – it's unlikely to be.

Action:
Even if your business has not undertaken complex tax planning, the level and complexity of the post-BEPS tax environment create heightened risks, many of which may not be immediately obvious. You need to carry out a global risk assessment across all operating territories to identify, evaluate and mitigate any risks. The evaluations should look at the reputational implications of tax policies, as well as the risks of audit, dispute and double taxation.

Adapt, improvise and overcome

BEPS is still in the early stages of implementation. But it's already clear that this will be a genuinely global regime, which embraces developed and emerging markets and offers little or no shelters. For the unwary, there are heightened tax risks and exposures. But the ability to anticipate and manage the changes will be a key source of competitive differentiation.

Given the uncertainties, complexities and speed of change, following the Marine Corps motto of 'adapt, improvise and overcome' would be wise. Get to know the terrain by charting developments, mapping scenarios and putting together clear contingency plans. And find out where you're vulnerable and address these areas.

At the same time, there are also opportunities to create a more informed and streamlined approach to tax management across multiple global operations. The impact of BEPS could also provide a valuable catalyst for reviewing your operating structures as you look to control costs, improve enterprise-wide oversight and develop the capacity to reach into new, fast growth markets.

If you would like to discuss any of the areas raised in this article, please contact your own Grant Thornton adviser or one of the contacts listed.

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