International Tax Planning may be "Harmful Tax Practice"

- the 2015 OECD BEPS final report

Aggressive tax planning is not quite the same as tax avoidance (illegal in most countries). Tax evasion is totally illegal and is clearly not the same as tax planning. Aggressive tax planning is part of the "Curbing Harmful tax practices" in Action 5 of the BEPS Action Plan.

What is BEPS?

The OECD/G20 says current international tax rules create opportunities for **Base Erosion and Profit Shifting (BEPS)**, a bold move is needed to ensure profits are taxed where economic activities take place and where value is created. Estimates using the global corporate income tax (CIT) revenue losses could be between 4% and 10% of global CIT revenues, i.e. USD 100 to 240 billion annually. The losses arise from, inter alia, aggressive tax planning by some multinational enterprises (MNEs) and harmful tax practices. The affiliates of MNEs in low tax countries report almost twice the profit rate (relative to assets) of their global group, showing how BEPS can cause economic distortions.

BEPS can result in **double non-taxation**, but addressing BEPS should not result in **double taxation**.

What is BEPS?

BEPS is a term used to describe some or all of the following activities :

- the use of mismatches between tax rules in different countries
- US check-the-box regime
- use of hybrid financial instruments and entities
- use of treaty classifications of income
- circumventing thresholds in treaty provisions
- intentional creation of permanent establishment
- avoidance of permanent establishment status through commissionaire agreements and specific activity exemptions
- splitting up of contracts
- limited profit attribution to permanent establishments through transfer pricing
- funding with debt or equity
- tax structures using a low-taxed group financing company
- notional interest deduction regimes

- payments to tax haven entities
- use of triangular tax structures using finance company with low-taxed finance branches
- tax structures using back-to-back loans
- holding companies not meeting substance and residence tests for tax treaty protection
- beneficial ownership requirement
- limitations on benefits provisions
- deduction/non-inclusion outcomes caused by character and ownership mismatches
- tax structures using hybrids and reverse hybrid, manipulating mismatches
- abusing domestic rules for entity classification
- arrangements that create double deductions outcomes
- arrangements that produce double non-taxation outcomes
- principal-purpose test under tax treaties

The OECD/G20 BEPS Project, started in 2013, set out Action Plans in its 2015 Final Report - below are brief excerpts from the BEPS 2015 Final Report :

- Include model provisions to **prevent treaty abuse, including through treaty shopping** in the multilateral instrument that countries may also use in bilateral tax treaties.

- Require MNEs to present standardised **Country-by-Country Reporting** to give tax administrations a global picture of where MNE profits, tax and economic activities are reported, and the ability to use this information to assess transfer pricing and other BEPS risks. MNEs to report their revenues, pre-tax profits, income tax paid and accrued, number of employees, stated capital, retained earnings, and tangible assets in each jurisdiction where they operate.

- A revitalised peer review process will **address harmful tax practices**, including patent boxes where they include harmful features, as well as a commitment to the mandatory **exchange of relevant information** on taxpayer-specific rulings.

- Other Action Plans include **limiting base erosion** through interest expenses via intra-group and third party loans that generate excessive deductible interest payments, and amend domestic legislation and related treaty provisions where necessary **to neutralise hybrid mismatches.** Countries to strengthen their domestic legislation on the mandatory disclosure by taxpayers of aggressive or abusive transactions, arrangements, or structures, and strengthen **effective Controlled Foreign Company (CFC) rules**.

- Make changes to **the permanent establishment definition** to address techniques used to inappropriately avoid the tax nexus, such as via commissionaire arrangements and the artificial fragmentation of business activities.

- Ensure that **Transfer Pricing Outcomes** are in line with Value Creation (Actions 8-10) the BEPS Report focused on three key areas. Action 8 looked at **transfer pricing issues** relating to controlled transactions involving **intangibles**. Misallocation of the profits generated by valuable intangibles has contributed to base erosion and profit shifting. Under Action 9, contractual allocations of risk are respected only when they are supported by actual decision-making and control over these risks.

- Action 10 focused on high-risk areas - addressing profit allocations resulting from **controlled transactions** which are not commercially justifiable, targeting the use of **transfer pricing methods** which results in diverting profits from the most economically important activities of the MNE group, and the use of certain type of payments between members of the MNE group (such as **management fees and head office expenses**) to erode the tax base in the absence of **alignment with the value-creation**.

"The OECD and G20 countries will extend their cooperation on BEPS until 2020 to complete pending work. They will, in early 2016, conceive a framework for monitoring with a view to better involve other interested countries and jurisdictions."

Information is not advice. The information provided in this paper should not be acted upon without professional advice. As this is an Executive Summary, important conditions and other details may be or are omitted. We accept no liability for persons who act on this publication without consulting us or their professional advisers.