OECD BEPS Project – latest round of stakeholder input

International Tax

01 August 2015

CIOT responses to OECD discussion drafts

The latest (and final?) round of OECD discussion drafts for public comment on the BEPS project were released in May and June. Several of these were second, or even third, discussion drafts focused on a particular action. The CIOT submitted responses to the discussion drafts which looked at BEPS action 7: preventing the artificial avoidance of PE status, following on from an earlier consultation and public meeting, and action 8: hard-to-value intangibles.

Action 7: preventing the artificial avoidance of PE status

We confirmed that the CIOT supports the aims of the OECD to tackle artificial avoidance of PE status in the areas identified. However, we stressed that the downsides (being much higher compliance costs for taxpayers, administration costs for tax authorities and more disputes) should not outweigh any benefits (being a re-allocation of tax base to the state where the sales and/or activities took place).

Although, generally, the OECD has adopted our preferred options from the first discussion draft, we explained that we would have preferred an approach to tackle artificial avoidance of PE status through commissionaire arrangements targeted at artificial structures only. While the proposed revised commentary is likely to address BEPS concerns, the proposals also amount to a broadening of the PE concept. This is likely to lead to more disputes over whether a PE exists, more PEs of low value in non-abusive cases and, consequently, an increased compliance burden for taxpayers and higher administration costs for tax authorities.

Our concerns about the prospect of more disputes over whether a PE exists, more PEs of low value in non-abusive cases and the increased compliance and costs burden for taxpayers and tax authorities also arise in relation to the decision by the OECD to recommend Option E to tackle artificial avoidance of PE status through the specific activity exemptions. We recognised that the proposal would significantly reduce BEPS activity aimed at exploiting the specific activity exemptions, but suggested that the cost of achieving this would be increased compliance for companies with a small presence in territories. In particular, the revised guidelines do not satisfactorily address the issue of what is an 'auxiliary' activity, and it is likely that some countries will regard a long-term presence involving one or two people undertaking a support activity as creating a PE, even if the profit attribution is small or even non-existent.

This is why we repeated the suggestion in our earlier response that there is a monetary threshold for sales, below which a PE will not arise. In our view a threshold and a de minimis level should be considered.

We also reiterated our hope that governments will provide enough resource to ensure effective and efficient resolution of the greater number of disputes that will arise. Having robust processes to solve disputes effectively and efficiently is vital to ensure that the objective of the BEPS process to tackle profit shifting does not lead to a damaging increase in double taxation.

Our full response can be found on the CIOT website.

Action 8: hard-to-value intangibles (HTVI)

We acknowledged that stakeholders in the BEPS project are aware that the pricing of inter-company transfers of intangibles has been a significant concern of tax authorities for some years. Tax authorities have, in public forums, shared examples of 'mispricing' of intangible transfers, where an enterprise has transferred an intangible at a low value which has subsequently generated a substantial income stream. It is a clear concern of tax authorities that multi-national enterprises can erode tax bases through moving intangibles to low-tax territories.

We agreed that it is a legitimate goal of the BEPS project to develop ways to prevent such behaviour. In our response, considering the proposals for the use of ex-post data in valuations put forward in the discussion draft, we focused on whether they

succeed in doing so without affecting commercial transactions not motivated by achieving tax reductions.

We said it was crucial that the proposals should not introduce into the international tax system the ability for tax authorities to open transfer pricing disputes or re-open agreed positions based solely on the application of hindsight where the authority simply does not like the ultimate outcome of the transaction. Business transactions involve an element of risk, and in commercial situations sometimes matters will not turn out as expected.

We also noted that the proposals would inevitably mean that tax positions remain open longer. For multi-national enterprises that remain unchanged for the period of uncertainty, the implications will not be too serious. However, these open tax positions will create difficulties and complications for any form of group restructuring or third party merger and acquisitions activities.

In terms of the behavioural response of taxpayers, we suggested that the proposals would lead to taxpayers choosing not to transfer intangibles within a group if there is any material degree of uncertainty over value – whether or not the transfer may be base-eroding, or how well the taxpayer believes it can justify its approach to valuation – as the tax result of such transactions would be uncertain as a result of the increased ability of tax authorities to consider ex-post data.

Further, we suggested that it follows that, given taxpayers will recognise that it will be difficult to transfer intangibles with certainty of tax treatment until they are sufficiently well developed for future income to be reasonably well measured, where intangibles are developed will become of greater significance. It would be rational for taxpayers to expand the development of intangibles in low-tax territories, and within regimes such as patent boxes to optimise the tax treatment of the future income derived from these intangibles.

In conclusion, we accepted that ex-post data is useful in some circumstances in the pricing of HTVI, and is likely to assist in preventing base erosion. However, we said its use should be restricted to cases where taxpayers cannot provide reasonable justification for ex-ante projections. In any event, it is likely to lead to a concentration of development of intangibles in low-tax and tax-favoured regimes.

Our full response can be found on the CIOT website.