Swift movement

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Alex Postma provides an overview of the challenges and opportunities for SMEs as they prepare for BEPS

Key Points

What is the issue?

BEPS is currently being built into tax legislation by national authorities.

What does it mean to me?

These new rules will likely affect the business operations of all enterprises that engage in cross-border activities, both large and small.

What can I take away?

As with any paradigm shift, there are opportunities as well as challenges for small businesses.

BEPS: six considerations for SMEs

Global tax reform isn’t just impacting large multinational companies. The Organisation for Economic Co-operation and Development’s (OECD) base erosion and profit shifting (BEPS) project, initiated in October 2015, is also impacting small- and medium-sized enterprises (SMEs) – and, in some ways, to an even greater degree.
BEPS is currently being built into tax legislation by national authorities. These new rules will likely affect the business operations of all enterprises that engage in cross-border activities, both large and small. The changes ahead are especially daunting for SMEs. These companies typically have less in-house tax expertise and resources at their disposal than larger companies. But, as with any paradigm shift, there are opportunities as well as challenges. SMEs have a particular advantage over their larger competitors: they can move more nimbly and swiftly.

Here are the six most significant areas for SMEs to address in the wake of global tax reform:

1. Providing more information brings both challenges and opportunities

Many SMEs will have to prepare to provide tax authorities with far more detailed information about their business operations than they have become accustomed to in the past. And while most reporting is expected to take place from 2017, certain countries will need to be notified by companies this year. Those that fail to do so risk a penalty for non-submission in some cases.

Companies with global revenues in excess of €750m must now report their business and tax footprint (country-by-country reporting) either to the tax authority in the country in which they are headquartered, or – if that country doesn't have the required legislation in place – to the many jurisdictions in which they do business. Much smaller companies must also provide tax information to the countries in which they operate. This so called 'Master File' information includes, among other things, an overview of their intangible property, supply chain, tax policies, financing and the agreements they have in place with tax authorities.

A prudent approach to these new requirements may unearth opportunities. In response to the improved consistency in the information tax authorities are requesting, combined with the increasing availability of information technology, some companies are moving towards the use of automated tax filings and transfer pricing documentation (TPD). For example, creating a centralized 'TPDoc' engine not only provides a more consistent and higher quality output at significantly lesser man-hours, but it also provides the enterprise with single entry access to significant amounts of data. By collecting and aggregating the data required by tax authorities, leading companies are now using it to facilitate new levels of business oversight, such as understanding and addressing underperforming segments of their enterprise.

2. Adapting international sales models

Companies that operate or sell across borders may have to adapt their sales models. The OECD has proposed new rules for creating a taxable presence: employees or agents that are involved in facilitating contracts in a foreign jurisdiction can now hold a business accountable for corporation tax in that jurisdiction. Furthermore, warehousing operations that did not previously give rise to local corporation tax obligations may now become subject to tax.

In some countries a physical presence may no longer be required. For instance, Turkey, Israel and India are all exploring the possibility of introducing a levy on companies' 'digital presence.' And, with corporation tax liabilities come filing obligations, not just for corporation tax, but also potentially for income taxes and social security – and possibly even indirect taxes. All of this means companies may have to rethink their international sales operations, their supply chain and mobility policies.

3. Addressing rising interest deduction restrictions

While some countries in the European Union (EU) already have measures in place to curb interest deductions in line with OECD proposals, the remainder of the EU will now face interest deduction restrictions by 1 January 2019. Limits to tax deductions of interest costs can impact companies' investment plans and M&A strategies, as well as affecting the tax cost of their current operations.

4. Reviewing IP business strategies

The OECD has also changed the rules around the recognition of intellectual property (IP) and related remuneration. Rather than looking at the formal, legal ownership of risk and capital, the value of IP is now considered to be created by people functions that carry the responsibility for making key management decisions. It is important, therefore, that companies review their IP business strategy – not only because the tax consequences around IP may have changed, but also because an IP business strategy document is required as part of the OECD's 'Master File' requirements.

5. Planning for controversy

Centralised planning, coordination and monitoring of tax issues has always been prudent; now it is becoming a business imperative. As the OECD's new rules are coming into play, tax authorities are increasing the amount of information they share with each other and are starting to explore data analytics tools for more efficient management of information. Settlements or agreements made with one tax authority may now become available to several other authorities. Tax-related decisions by one local subsidiary of a multinational company can have strong repercussions for other subsidiaries and for the company as a whole. It is important, therefore, that companies establish and document well-developed global tax policies and deploy them consistently around the world in their tax filings and discussions with tax authorities.

6. Redefining the operating model at pace

The fundamental shifts described above are forcing companies to re-evaluate the rationale of many operational and strategic aspects of their business, including supply chain management, sales operations, research and development (R&D), IP and talent. Does it still make sense to work with sales agents? Should R&D decision-makers be relocated? Is the operating model fit for purpose, including its inventory policies? These are just some of the questions companies should be considering when addressing their operating models.

Global tax reform and the wider business implications of this profound shift are inextricably linked. The fundamental question is whether current operational structures and processes still make sense from a business and tax perspective. SMEs that quickly and effectively redefine their business and tax models and eliminate current inefficiencies in the process may be able to establish an operating model better suited to the new environment. This could well give them a clear edge over less proactive competitors.

The OECD’s BEPS Action Plan and its implementation by countries around the world produces clear challenges for small and medium-size multinationals. However, SMEs may indeed be better equipped to deliver quick and effective responses, establish closer cooperation across business functions, drive centrally coordinated tax policies more efficiently and embrace some of the key challenges as opportunities. It is not a question of if, but when the changes are coming; being intellectually proactive by noting, addressing, reacting and modifying approaches and processes in a timely and efficient manner will be a key for SMEs.