BEPs continues apace

Technical

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The CIOT has responded to the discussion drafts published by the OECD before Christmas, as the OECD continues its work on the BEPS project. At the time of writing, the OECD is poised to present the latest developments in the OECD/G20 project at a G20 finance ministers meeting in Istanbul (9–10 February).

Action 14 – Dispute resolution

In our response to the discussion draft on making dispute resolution more effective, the CIOT noted that the OECD's Mutual Agreement Procedure (MAP) statistics for the years 2006 to 2013 show that the number of treaty-related international disputes has almost doubled in recent years. The CIOT expects that the outcomes of the OECD BEPS action plan, which are likely to change important concepts in tax treaties, will result in further increases in such disputes. Therefore the CIOT welcomed the work to identify and address the obstacles preventing countries resolving disputes through MAP. Improving MAP is essential if double taxation is to be reduced.

We noted, however, that it was disappointed by the lack of consensus on moving towards universal mandatory binding MAP arbitration, suggesting that it is important to accept proposal to adopt minimum standards of responsiveness by all member states to the challenges identified in the Action 14 paper.

Our response can be found at: www.tinyurl.com/l9kkeu4

Actions 8, 9 and 10 – Transfer Pricing Guidelines – risk, re-characterisation and special measures

The CIOT supports the aims of the OECD to ensure that transfer pricing outcomes are in line with the economic substance of a transaction including, in particular, value creation. However, we had some general comments on the approach being

suggested in the discussion draft.

In general the revised Section D of Chapter I of the Transfer Pricing Guidelines (Section D) set out in Part I of the discussion draft effectively identifies the circumstances in which to look beyond the contractual documentation to determine the appropriate treatment for transfer pricing purposes.

However, we have concerns about the circumstances in which it is suggested that an entity, which has a separate legal personality, can be overlooked or ignored. The concept of an entity having a separate legal personality is a fundamental legal concept and the ability of a legal person to contract and take on risk and be rewarded is fundamental to the international trading system.

We suggested to the OECD that caution should be exercised before suggesting that legal entities should be ignored on the basis that they have no purpose in a particular transaction. To do so would undermine the fundamental legal concept of separate legal personality.

We also sought assurance from the OECD, and suggested that it should be made clear in any special measures adopted that these are intended to be a back-up to the guidance in Section D. We would be concerned if tax authorities were to invoke special measures too readily.

Our response can be found at: www.tinyurl.com/kpcabog

Action 4: Interest deductions and other financial payments

The discussion draft on Action 4 focuses on group-wide interest limitations based around a group's external borrowings. In our response to the OECD we note that the CIOT is far from convinced that an interest limitation rule is the best option to address the BEPS concerns arising from interest deductions.

We note that other actions of the BEPS project are addressing several base erosion issues related to interest deductibility, and differences between countries regarding the treatment of debt are a natural part of an international tax system in which countries retain sovereignty over tax matters.

Although we support the work the BEPS project is doing to counter arrangements which have (rightly) caused so much public concern, the proposals set out in the

Action 4 discussion draft go beyond addressing the splitting of profits from the activities that generate those profits. The proposals seek to harmonise the rules that countries have for determining how much interest is tax deductible, even in situations where the profit generated is commensurate with the activity performed and in situations where no tax advantage arises.
It seems that domestic rules on which expenses qualify for tax relief are, as much as headline rates of tax, matters for each country to determine, taking into account all aspects of its tax system (for example, its CFC regime). As such, we take the view that the approach adopted by this consultation document goes well beyond the scope of the BEPS project. The area addressed in this discussion draft is different from the other areas addressed by the various BEPS actions. It considers an issue that is fundamental to all businesses – how to finance the business. This is very different from tackling, say, hybrid mismatch arrangements, which are a specific tax tool that can be used by MNEs. Every group has to finance its business.

Our response can be found at: www.tinyurl.com/q836vhr

The next discussion drafts are expected from the OECD in March/April 2015. If anyone has any comments on the BEPS project, please contact me.