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Much ado about nothing? The OECD BEPS initiative

http://docs.bepartners.pro/BEPS_Action_Plan.pdf

On September 20th, the organization for economic cooperation and development (OECD) presented the first results of its action plan on base erosion and profit shifting at the G20 summit in Australia. The OECD, an intergovernmental organization of 34 member countries, received the order last year to set up an action plan on base erosion and profit shifting, the BEPS project. Whereas in the past, the OECD did its work in the area of avoidance of double taxation, the direction of this project is to avoid double non-taxation.

In the same way non-harmonized tax law can lead to double taxation of profits, the missing harmonization of national tax laws can also result in non-taxation in any of the national jurisdictions. This is not about illegal tax planning. It is about applying the national tax law and using the lack of harmonization as an advantage in international tax planning. Another aim of the action plan is to stop harmful tax practices. Harmful tax practices, in the view of the OECD, is the so-called race to the bottom; it is unclear, however, if high taxation would then mean good tax practice. Furthermore, the action plan should serve to increase international tax justice.

Is it much ado about nothing? By no means. It is important that the OECD member countries meet and talk about their tax politics. Tax politics need to be harmonized, although, in our view, the avoidance of double taxation is still more important than the avoidance of non-taxation. Furthermore, will BEPS serve to increase international tax justice? Not at all. BEPS should not be overestimated in this respect.

The action plan is not about international tax justice. It is about local tax payers missing out on the opportunities that global tax payers may enjoy by being able to take advantage of cross-border tax structuring welcomed by some countries, even some of the G20 states. Will national states in the future try to find a fair solution for all member countries? Or will they keep on trying to reach a single advantage for their jurisdiction to the detriment of the other member countries? It is a question of the individual countries' strategic thinking and their view as to how to play the prisoner's dilemma.

The countries are taking different views on this issue. In its September 23rd edition, the Wall Street Journal describes BEPS as a monster and states: "If more employment and better public finances are what leaders of the G20 really want, they can start by renewing their commitment for free trade, deregulation and pro-growth tax reform at their November summit in Australia." Great Britain wants to be the number one tax place in the league of the global tax competitors (The Economist, edition September 20th, p. 71).

We do not think that the countries are ready to let fall national interests for the fair allocation of taxes between all member countries. Nor do we see any need for taxpayers to prepare in reaction to BEPS. However, we think that due to pressure by their voters and the lack of empathy with big international players, politicians will go for national solo action. We therefore think that the questions especially of substance and real economic activity in the taxing country will come up. If investment management players are already thinking of revising structures or shifting functions for other reasons, for example in the course of the reorganizations due to the AIFMD, these political efforts should be taken into consideration. For example, moving middle management to the country where the AIFM is located should be considered.

In the following you will find the links to the BEPS initiatives published to date. As we stated above, we do not think it likely that something will happen in the end; however, if contrary to our assessment it should be otherwise, we have included a brief overview of the impact for funds and fund structuring:

Action 1 Addressing the tax challenges of the digital economy

http://docs.bepartners.pro/news/Addressing_Tax_Challenges_Digital_Economy.pdf

Minor impact for investment management.

The main issue is the requirement of a fixed place of business within the concept of a permanent establishment and the taxation of a "digital presence."

Action 2 Hybrids:

http://docs.bepartners.pro/news/Neutralising_Effects_Hybrid_Mismatch_Arrangements.pdf

Major impact for investment management.

The issue is not only hybrid financial instruments, but also hybrid entities. Funds in contractual form as well as funds formed as partnerships may be affected. This issue is already unclear in many countries.

Action 5 Countering harmful tax practices, transparency and substance:

http://docs.bepartners.pro/news/Harmful_Tax_Transparency_Substance.pdf

Minor impact for investment management.

The focus is the taxation of intangible assets: patent boxes, etc.

Action 6 Treaty abuse:

http://docs.bepartners.pro/news/Preventing_Granting_Treaty_Benefits_Inappropriate_Circumstances.pdf

Moderate impact for investment management.

Treaty shopping under a double tax treaty through artificial structuring is to be made more difficult. Some approaches include general anti-abuse clauses or specific clauses in treaties (limitations on benefit). It can hardly be made more difficult than under the German national provisions set forth in §50 d of the German Income Tax Act (Einkommensteuergesetz, or “EStG”).

Action 8 Guidance on transfer pricing aspects of intangibles:

http://docs.bepartners.pro/news/Transfer_Pricing_Intangibles.pdf

Minor impact for investment management.

This deals with the definition and treatment of intangible assets.

Action 13 Guidance on transfer pricing documentation and country by country reporting:

http://docs.bepartners.pro/news/Transfer_Pricing_Documentation.pdf

Moderate impact for investment management.

The issue is the determination of where the profits are generated and who may tax them. If country by country reporting is not in line with the transfer pricing documentation, fiscal authorities will ask questions.

Action 15 Developing a multilateral instrument to modify bilateral tax treaties:

http://docs.bepartners.pro/news/Developing_Multilateral_Modify_Bilateral_Tax_Treaties.pdf

Major impact for investment management.

This deals with the implementation of a multilateral international agreement that should force the individual countries to amend all of their separately concluded double tax treaties. This would mean plenty of changes and amendments all at once for international funds.

be in touch: If you have any questions, please do not hesitate to contact us!

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