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Centre for Tax Policy and Administration
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Via Letter

**RE: Tax Executives Institute Comments on the OECD's
Action Plan on Base Erosion and Profit Shifting**

To Whom It May Concern:

On 12 February 2013 the OECD published a document entitled *Addressing Base Erosion and Profit Shifting* (hereinafter the BEPS Report or the Report). As promised in the Report, the OECD published its *Action Plan on Base Erosion and Profit Shifting* (the Action Plan or Plan) on 19 July 2013 setting forth 15 actions the OECD will undertake to address a series of issues that contribute to the perception that individual countries' tax bases are being eroded or profits shifted improperly. As part of the BEPS project, the OECD will hold a meeting with the Business and Industry Advisory Committee (BIAC) on 1 October 2013 to solicit business comments on the Action Plan. On behalf of Tax Executives Institute, Inc. (TEI or the Institute), I am pleased to submit the following comments addressing the overall goals and approach of the BEPS project in advance of the October meeting. The Institute anticipates submitting detailed comments addressing many of the individual actions in the Action Plan.

TEI Background

TEI was founded in 1944 to serve the needs of business tax professionals. Today, the organisation has 55 chapters in Europe, North America, and Asia. As the preeminent association of in-house tax professionals worldwide, TEI has a significant interest in promoting tax policy, as well as the fair and efficient administration of the tax laws, at all levels of government. Our nearly 7,000 members represent over 3,000 of the largest companies in Europe, the United States, Canada, and Asia.

Introduction

The OECD's Action Plan is an ambitious document with a broad scope – addressing transfer pricing, hybrid arrangements, treaty abuse, the definition of a permanent establishment, the digital economy, and indirect tax issues, as well as other items. The Action Plan notes that “[t]he BEPS project marks a turning point in the history of international cooperation on taxation”¹ and prescribes an aggressive timeframe for the production of proposals, consultation documents, and other output for each of the 15 actions within 12 to 30 months. The Action Plan notes that the weaknesses in the international tax system it identifies “put the existing consensus-based framework at risk” and that inaction in this area “could lead to global tax chaos marked by the massive re-emergence of double taxation.”²

TEI appreciates the OECD's efforts to spur reform of the present international tax system. We question, however, whether the ambitious timelines reflected in the Action Plan will allow the OECD to lay the consensus-based framework necessary to achieve the fundamental reform it seeks. By comparison, the OECD's project on the transfer pricing aspects of intangibles, a much more focused endeavor than the BEPS project, began in July 2010 and is still not complete. The current lack of consistent tax rules among OECD Member States, as detailed in the BEPS Report and Action Plan, creates both opportunities and costs for international business. Given the project's broad scope and tight timeframe, it is critical that the OECD not lose sight of the basic principles underlying the current international tax system and take into account the concerns and views of the taxpayers most affected by the Action Plan: MNEs. A full and fair consultation on each of the respective actions and consideration of the interaction among the resulting proposals is critical to the success of the BEPS project. Thus, we caution that if this project is pushed through in an accelerated timeframe, fails to achieve consensus among the OECD Member States and G20 countries on fundamental questions, and cuts short the consultation process, the OECD runs the risk of creating the “global tax chaos” it seeks to avoid.

Due to the current political climate and pressure from the G20 countries, however, it appears that the OECD is determined to address the base erosion and profit shifting concerns laid out in the BEPS Report and Action Plan in an accelerated manner. Set forth below are high-level principles and concerns that TEI believes the OECD should take into account when formulating specific proposals to implement the 15 steps of the Action Plan.

General Comments

Maintaining the integrity of the international tax system that has developed since the League of Nations' efforts in the 1920s is paramount to safeguarding the benefits of our current global economy. Because of the importance of the taxing power to the wellbeing of a state, tax

¹ Action Plan, page 25.

² *Id.* at 10-11.

rules generally favor the tax collector. For example, the rules generally place the burden of proof in a dispute on taxpayers, require extensive documentation (especially in the area of transfer pricing), and allow the imposition of what can be punitive penalties even in the absence of fraud. Regrettably, over the past five years due to the global recession, tax administrations have often used the favorable tilt of the tax laws to increase their revenues, rather than applying them in a fair and even-handed manner to determine the correct amount of tax due. As a result, taxpayers have been pressured to agree to unprincipled settlements rather than face the uncertainty and cost of litigation. In many of these cases, the revenue of a second state is negatively impacted by such unprincipled adjustments (*e.g.*, by granting a credit for the increased amount of tax). In TEI's view, therefore, a productive output of the Action Plan's goal to protect the economic benefits of the current international tax system would be to create an effective and efficient mechanism for taxpayers to dispute these adjustments, as well as involve other countries where their interests are at stake.

As the BEPS Report and Action Plan note, however, the continued enjoyment of the benefits of the current international tax system may be at risk due to the unprincipled actions by revenue authorities, the contentious political climate, and the interaction of domestic laws, bilateral tax treaties, and other aspects of the current system. Another factor contributing to the instability of the international tax system that is generally unrecognised by the Action Plan is the purposeful implementation of favorable tax regimes and rules by OECD and G20 Member States (among others). States enact these regimes in an attempt to attract and retain business activity and capital investments for the economic benefit provided, including jobs and business and individual tax revenue. Because the Action Plan does not address this factor, it also does not address when governments may implement fiscal incentives in their domestic legislation. The OECD could, for example, define or provide guidance on what is and is not "fair" tax competition and accompany such guidance with a rapid and effective dispute mechanism. We encourage the OECD to address these core issues.

In addition, rather than viewing cross-border payments for goods or services within an MNE as a natural consequence of global trade, the Action Plan seemingly views such payments as "base erosion." This unfortunate implication is neither helpful nor accurate since such payments are also base accretive for the receiving jurisdiction and a consequence of the arm's length principle which the OECD ardently defends. The BEPS project would benefit from an explicit recognition that related party transactions are a necessary and critical component of conducting business around the world.

Over the past decade, the growing instability in the international tax system has led to increased controversy between taxpayers and tax administrations creating an unnecessarily hostile audit environment for MNEs. As important, the instability in the system has led to an increasingly contentious environment among countries, trapping MNEs in adversarial, drawn-out mutual agreement procedures that fail to fully resolve all double taxation issues. Thus, a welcome result of the OECD's BEPS project would be additional clarity for the complex system

for settling disputes among countries and the reaffirmation of a taxpayer's right to challenge an assessment in a fair, efficient, and neutral proceeding.

The General MNE Perspective

Conducting international business is an expensive and risky endeavor because of the many obstacles that must be overcome, including inconsistent legal rules across jurisdictions. MNEs address these challenges by developing best-in-class processes to be fully compliant with their legal obligations, including tax. MNEs create, maintain, and adhere to robust tax compliance and documentation policies as part of their internal controls to manage tax risks. As a result, the vast majority of MNEs properly report their revenue and income to taxing authorities around the world and pay the proper amount of tax due.

Nevertheless, drawing the line between acceptable tax planning for ordinary commercial transactions and aggressive tax planning or tax avoidance transactions can be challenging. In addition, the hostile political climate surrounding the amount of taxes paid by MNEs is deeply troubling since in many cases the resulting low rates arise because MNEs have applied the rules correctly. Indeed, in many cases the MNEs are responding to the capital investment and tax incentives afforded them by the same OECD and G20 Member States whose leaders are now promoting the BEPS project. In an ideal world, revenue laws would be clear, equitable, and administrable and distinguish abusive transactions from acceptable tax planning. The rules would also be consistently applied across jurisdictions in audits and other administrative (and judicial) proceedings.

Clarity and Predictability – Coordination among Action Plan Steps

TEI agrees with the Action Plan's statement that the BEPS project cannot succeed without "certainty and predictability for business."³ Of paramount importance to MNEs is an international tax system that provides a coherent and consistent set of rules that underlies and provides predictability and certainty.

To impart this certainty, the rules arising from the BEPS project must reflect a consensus view of the international tax system and facilitate consistent application of those rules across the OECD Member States and other G20 participants. The risk that OECD members and other nations will adopt only a portion of the recommended actions is palpable. Jurisdictions will be tempted to selectively implement the rules, recommendations, and other guidance that best fit their local economies and maximise their tax revenue. This would worsen the patchwork of rules that currently exist and increase the risk of double taxation and even double non-taxation. We recommend that the OECD carefully coordinate the BEPS project across the 15 actions and make clear that wholesale adoption of the BEPS output is preferred to a "pick and choose" approach. To provide transparency and place business on notice of issues and circumstances

³ *Id.* at 14.

where participants do not necessarily agree, the OECD should identify and publish the dissenting views alongside the recommendations.

To address the inevitable disputes and disagreements that will arise even under the most carefully crafted and administered rules, a comprehensive, robust, and efficient mutual agreement procedure (MAP) must be in place to address instances of double taxation. We are encouraged that such a procedure is the subject of Action 14 and that it references the potential inclusion of a mandatory binding arbitration provision, which TEI supports. We also applaud the development of a multilateral instrument as set forth in Action 15 as a mechanism for settling multilateral disputes, as well as bilateral ones. Regrettably, even where there is a MAP process available to a taxpayer, the competent authorities may lack the resources to effectively and efficiently process the case.

Finally, there is a need for clear separation between modifications to the transfer pricing rules and other grounds for anti-avoidance challenges. The Action Plan describes various anti-avoidance measures, such as the denial of interest deductions, anti-hybrid rules, and general anti-avoidance rules (among others), in the same action step or even the same sentence. This approach risks doctrinal confusion and inappropriate application of transfer pricing principles (*e.g.*, as an automatic fall back or grounds for re-characterisation of a transaction where the assertion of a general anti-avoidance rule is not well grounded). The OECD should clearly separate one anti-avoidance measure from another and note that not every such measure is appropriate in all circumstances.

The Arm's Length Principle

The Action Plan notes that “there is consensus among governments that moving to a system of formulary apportionment of profits is not a viable way forward.”⁴ TEI welcomes the OECD’s statement that formulary apportionment is an unworkable alternative to the arm’s length principle. Regrettably, the Action Plan undermines this re-affirmation of that principle. For example the Plan states that “special measures, either within or beyond the arm’s length principle, may be required with respect to intangible assets, risk and over-capitalisation to address” flaws in the current system of determining the appropriate transfer price.⁵

TEI submits that undermining the arm’s length principle is a risky endeavor with uncertain results. “Special measures” that go “beyond” the arm’s length principle will inevitably lead to greater uncertainty unless the measures are limited to a small set of clearly defined cases of abuse. Should the OECD determine that it is necessary to deviate from the arm’s length principle to achieve the underlying goals of the Action Plan, it should clearly define the cases to which such a deviation will apply and prescribe how to derive the appropriate transfer price under such limited circumstances.

⁴ *Id.*

⁵ *Id.* at 20. Actions 8, 9, and 10 all refer to “special measures.”

Double-Taxation vs. Double-Non-Taxation

One of the underlying themes driving the BEPS project is the concept of double non-taxation. The Action Plan notes that fundamental changes may be necessary to address the underlying issues that lead to base erosion and profit shifting, including potentially moving away from the arm's length principle, addressing hybrid arrangements and tax arbitrage, as well as solving so-called "treaty abuse."

Although taxpayers would welcome measures to delineate unacceptable tax practices and transactions, the OECD should not push the pendulum so far in the other direction that it leads to a resurgence of double taxation that the OECD has long sought to mitigate. Indeed, the Action Plan notes that double taxation may come to pass if the OECD does not address base erosion and profit shifting through its BEPS project. To strike the right balance, we recommend that minimising double taxation in addition to minimising double non-taxation be one of the shared goals of the 15 action steps. Unfortunately, it seems that a regular approach of tax authorities when it comes to international tax issues is to concentrate only on their short-term national interest by increasing revenue, which leads in the long run to the risk of double taxation. Instead, the OECD should encourage tax authorities to consider long term consequences when developing tax policies and audit approaches, which would take into account the impact and interaction of their decisions with other countries' tax laws.

Jurisdiction to Tax

The Action Plan notes that "[w]hile actions to address BEPS will restore both source and residence taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at a very low rate, these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income."⁶ While we appreciate that the OECD will not directly address the allocation of taxing jurisdiction, its actions will undeniably do so indirectly. Where the BEPS project would result in the expansion or "restoration" of taxing jurisdiction directly or indirectly, the OECD should consider whether a corresponding contraction of taxing jurisdiction might also be warranted.

Timing & Output, Consultation with Stakeholders, and Other issues

We note that the Action Plan sets an aggressive timetable for output from the 15 action steps. The need to meet an arbitrary deadline, however, should not come at the cost of compromising the quality of the OECD's output or minimising consultation. We also urge the OECD not to lose sight of the two actions that have the most potential benefits for business: actions 14 and 15. These two actions have deadlines near the end of the overall Action Plan and should not be given short shrift or deprived of the OECD's attention and resources. The OECD

⁶ *Id.* at 11.

should also seek input from as wide a range of industries and sectors as possible since not all businesses face identical issues. TEI stands ready to assist the OECD in this effort.

We also welcome the participation of the United Nations in the BEPS project as well as G20 countries that are not members of the OECD. The OECD should consider an increased engagement or coordination with other supra-national bodies such as the Association of Southeast Asian Nations (ASEAN) and others to address issues that might be more relevant to certain geographies (such as the existence of large, state-owned enterprises and the equitable application of the BEPS project recommendations to such enterprises).

We note that many, if not most, non-OECD members have little or no experience implementing OECD guidance domestically. Indeed, many of these states have had challenges implementing the current slate of OECD guidelines and may now be faced with wholesale change. Business may therefore be faced with an unfortunate patchwork of differing rules as a result of the BEPS project as more experienced states forge ahead with their domestic legislation while less experienced states lag behind. The working groups should keep this in mind when devising their solutions to the problems identified in each step. Thus, careful consideration should be given to whether the BEPS recommendations should be adopted via domestic legislation, changes to the OECD transfer pricing (or other) guidelines, or through changes to the OECD model tax convention. For example, many countries import the OECD transfer pricing principles into domestic law by reference to the OECD transfer pricing guidelines. It may be sensible to recommend that countries adopt the same approach to implementing changes from the BEPS project, particularly if the modifications recommended by the Action Plan are incremental, rather than wholesale updates to current OECD guidance.

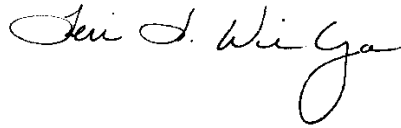
Finally, the OECD should make clear that any proposed changes to the international tax system that result from the BEPS project are to be applied prospectively. In the past, many taxing authorities have used revised guidance when applying local law to transactions that took place long before the revised guidance was issued and in a manner contrary to the guidance in effect at the time of the transaction. Prospective application of changes arising from the BEPS project would provide business with the confidence to make decisions based on the current system. Consideration should also be given to “grandfathering” rules for taxpayer business structures and transactions, which should remain in place until the transfer pricing rules of both countries to the related party transaction adopt a BEPS recommendation.

Conclusion

TEI appreciates the opportunity to comment on the OECD’s BEPS Report and Action Plan. These comments were prepared under the aegis of TEI’s European Direct Tax Committee, whose Chair is Alexander Kölbl. If you have any questions about the submission, please contact Mr. Kölbl at +41 58 158 88 97, Alexander.Koelbl@gdels.com or Benjamin R. Shreck of the Institute’s legal staff, at +1 202 638 5601, bshreck@tei.org.

Sincerely yours,

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