The biggest shake-up in international tax rules in a generation is here

October 2015

On October 5, the Organisation for Economic Co-operation and Development (OECD) unveiled its comprehensive action plan to combat base erosion and profit shifting (BEPS). Mandated by the G20 in 2013 to develop this action plan in response to the increasing public and political furor over high profile multinationals using BEPS strategies to minimize global corporate taxes, the OECD released 15 reports. Together, they propose a radical overhaul of international taxation to improve the coherence of and collaboration between international tax regimes, align taxation with substance/value creation and increase transparency to aid tax authorities in risk assessments. If the proposals are implemented, they will put an end to many international tax planning strategies and significantly influence cross-border trade and investment decisions.

The OECD is presented the BEPS reports to the G20 finance ministers at their meeting in Peru on October 8 and will present them to the G20 leaders for approval at their meeting in Turkey on November 15-16. The challenge of implementation will then begin.

According to our latest International Business Report (IBR), a quarterly survey of 2,580 businesses in 35 economies, 74 percent of businesses would welcome more global cooperation and guidance from tax authorities. They would like to know what is and is not acceptable tax planning, even if this provides less opportunity to reduce tax liabilities. So will the BEPS proposals result in a tax system that is fairer, more efficient and more understandable? What are the risks and opportunities that may arise?

Damaging uncertainty

The increasingly high level nature of international taxation has in turn generated a lot of discussions within boardrooms. As long as businesses operate within regulatory boundaries, they have a responsibility to their investors to keep costs down—and this includes tax. But it's when executives are called up to answer legislative committees' questions that we see the extent of the shift in scrutiny. It's not whether companies are acting within the law, but whether they ought to pay more.

The problem is that there are no firm guidelines to help decision making. Simply telling businesses to pay their "fair share" is not a viable alternative to a clear set of rules or principles. What constitutes a fair share? Businesses need things to be black and white, but what they are getting is a lot of grey. They are increasingly faced with challenges from various taxation authorities, often resulting in double taxation since dispute resolution procedures have proven ineffective.

Disparities remain

So will the OECD's proposals, if implemented, deliver greater clarity on what is perceived to be both legal and acceptable? The OECD deserves credit for its readiness to consult and for getting so far, so quickly. Yet these proposals come with a large caveat: the OECD does not set laws or sign tax treaties—governments do. The effectiveness of some of the proposals will be determined by their widespread and consistent implementation. There is bound to be a significant variation in the timing of implementation and interpretation of how the rules are applied. Less than a quarter of the business leaders interviewed for our IBR survey believe there will be a global agreement on BEPS. Recognizing that companies operate in a highly global and digital economy, the OECD developed an action plan that necessitates comprehensive and coordinated action by countries to close controversial loopholes in the international tax system. None of the OECD and G20 member countries objected to any of the reports, and, somewhat surprisingly, all agreed to the timely implementation of four of the 15 measures to avoid the chaos that would have transpired had they not implemented them consistently. What was also surprising was the announcement that a significant number of countries, including Canada, have joined an ad hoc working group to negotiate a multilateral agreement to implement the treaty-based measures on an expedited basis, bypassing the need for bilateral negotiation of treaties. The expectation is that this agreement will be ready to sign by the end of 2016. If agreed to, this will result in the simultaneous amendment of thousands of treaties.

Some countries, notably the United Kingdom and Australia, have already jumped the gun by announcing legislation that covers some of the BEPS actions. Other major economies, notably the United States, may take longer. The United States is planning to bring in country-by-country reporting in 2016 and has proposed changes to its model tax treaty, but the wider reforms are unlikely to get onto the legislative agenda before the 2016 Presidential election. In turn, countries outside the OECD, including China and India, are already indicating that they want to introduce certain elements of the OECD's plan. From a Canadian perspective, Canada already has fairly robust international tax rules and may not have an incentive to implement many of the BEPS proposals, particularly those that would reduce the competitiveness of Canadian multinationals. Even so, expect Canada to address treaty shopping, interest deductibility limitations and the country-by-country reporting/transfer pricing documentation proposals.

The big question is, therefore, how much coherence between international regimes will be achieved? We need a tax system that keeps pace with an increasingly borderless digital economy. Rather than a patchwork of local rules, the G20, UN and OECD should take the lead in ensuring the tax system is sufficiently clear and consistent to allow businesses to manage tax with certainty. The results would be good for businesses, consumers and governments. Anything less will simply create more anomalies, more loopholes and more uncertainty.

Standing up to scrutiny

The immediate priority for businesses is to consider how their current tax arrangements will come across under the much greater level of transparency and judge whether they are comfortable with this. The way the reporting rules are set up means that even companies with relatively straightforward tax affairs could find themselves in the firing line. The broad scope of the BEPS package also means significant implementation and reporting headaches ahead.

There will also be some opportunities. In particular, the new rules are likely to create a more even playing field for tax strategy and cost. Greater international harmonization would in turn mean fewer cross-border issues to contend with.

Charting difficult waters

Is the BEPS package a step in the right direction? International tax rules clearly need to be stripped down and rebuilt for the world we live in, and this is what the OECD proposals aim to do. But there are a lot of tricky waters to navigate. It may be some time before genuine clarity over acceptable tax planning emerges, so it's vital that businesses understand the potential risks and are able to justify their decisions.

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