

Navigating BEPS: What the tax function of today needs to know for tomorrow

The Organisation for Economic Co-operation and Development (OECD) has described its newly unveiled Base Erosion and Profit Shifting (BEPS) Action Plan as a "change of paradigm."¹ A few very large global groups aside, a more apt description may be a minefield for the unwary.

BEPS has received considerable air time over the past few years, to the extent that there is a fear that businesses have become detached from the process. But it's now that they should be critically appraising their current structures to make sure they are fit for purpose in the post BEPS environment. Heads of tax are facing headaches: divergences in domestic legislation, archaic tax authority dispute resolution mechanisms and an eagerness from tax authorities around the globe to ensure they collect their "fair share" of tax.

In this article we look at the practical impact of the OECDs recommendations and the key issues that should be on your radar as a tax function and head of tax. We explore how to address these issues and the risks and opportunities they create. We also look at how the tax role within the business is likely to change and the opportunities that this presents.

Businesses are still uncertain of the next steps. The central challenge is dealing with what will be marked variations in how the 15 actions are interpreted and the timing of implementation in the locations where your business operates. Divergence is likely to be heightened by the fact that while there are some red lines that need to be consistently applied, the bulk of what's been announced are recommendations rather than hard rules.²



¹ The Economist, 10 October 2015.

² For more information on the implications of each of the 15 articles in the Action Plan please see <http://www.grantthornton.co.uk/en/insights/base-erosion-and-profit-shifting-beps-action-plan-what-does-it-mean-for-you>

Clarity over tax liabilities is a vital part of a business's ability to plan for the future and invest in growth. Yet at a time when tax is more scrutinized, politicized and emotive than ever, it's becoming increasingly difficult for businesses to know they're on the right track. The dilemmas are heightened by the fact that the question is no longer just whether a business is acting within the law, but whether it ought to pay more. Tellingly, our quarterly International Business Report (IBR) survey found that 75% of participants would welcome more global co-operation and guidance from tax authorities on what is acceptable and unacceptable tax planning, even if this provided less opportunity to reduce tax liabilities.³

Although it is premature to begin unwinding BEPS targeted structures, it is advisable to review these structures from a risk-benefit perspective, strengthen substance where possible and develop strategies for restructuring or unwinding structures in a tax efficient and timely manner.

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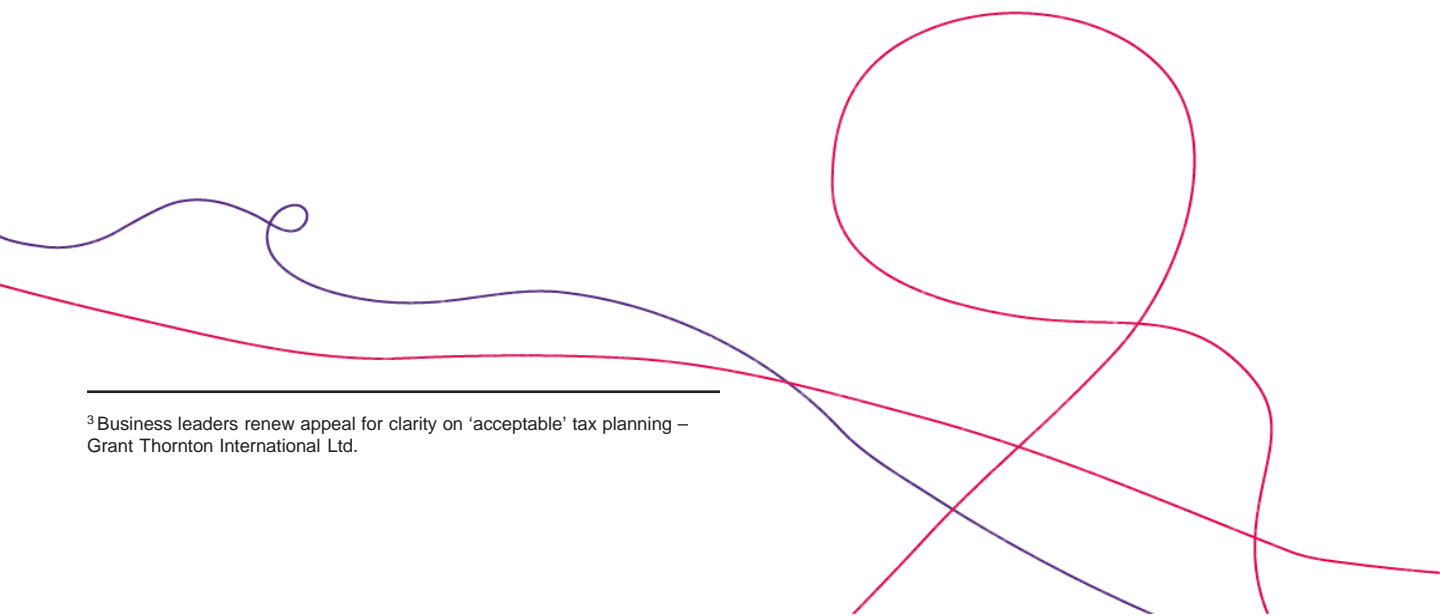
So will the BEPS recommendations bring clarity?

The finalized Action Plan does set some minimum standards in areas where a lack of application could create an uneven playing field. These include country-by-country (CbC) reporting and measures to combat harmful tax practices, prevent treaty shopping and improve dispute resolution. The remaining proposals are less prescriptive. And as it is national legislatures rather than the OECD that enact laws and tax treaties, the room for variations in local interpretation and application is considerable. The proposed limitations on interest deductions are a case in point. The OECD recommends a restriction on interest deductions over a certain percentage of profits (between 10 and 30%) but they leave the exact ratios and implementation to national governments to decide. Nevertheless, by effectively removing the arm's length principle for financing, this action could be costly and have significant implications for your tax management.

Action:

The BEPS Action Plan indicates that some operational restructuring and adjustments to transfer pricing may be required by businesses. But given the current uncertainty it would be beneficial to model the different outcomes and develop clear contingency plans rather than taking hasty action now.

³ Business leaders renew appeal for clarity on 'acceptable' tax planning – Grant Thornton International Ltd.



What about non-OECD states?

The entire G20, including countries outside the OECD such as India and China, has agreed to bring in CbC reporting for large groups. There will also be a requirement for groups to prepare a central master file as well as local transfer pricing reports. Of the non OECD G20 countries, China in particular has been an active contributor to the BEPS Action plan and is codifying a majority of BEPS concepts in its new domestic transfer pricing legislation.⁴ These are notable steps forward in international harmonization and other countries in the Asia Pacific region are looking to follow China's lead. But regarding other measures, the non-OECD states are likely to pick and choose rather than enacting the Action Plan in its entirety.

Headaches and dilemmas

This patchwork of different local rules is clearly an administrative challenge for you and your team. The uncertainty is compounded by what will eventually be multiple compliance arrangements.

You also face tough strategic questions. Once in place, the newly enacted legislation may require shifts in tax policy and movements in people, operations and tax location. But what changes you make and when you put them in place very much depends on how the proposals are applied in your different operating territories.

Action:

We believe that interest rate deduction is one of the grey areas where your tax teams should model the implications of different levels of deductions, and consider how to deal with the varying outcomes. However, it would be unwise to make wholesale changes before you know what fixed ratio each of the legislatures settles on.

In the line of fire

Further challenges centre on how the new measures will be used by local tax authorities. In particular, a lot of countries believe that they should be entitled to more tax revenue. BEPS recommendations, if implemented, will see shifts in liabilities towards where value is created (substance). The result is almost certain to be an increase in inter-state disputes as authorities vie over the taxing rights. If countries can't agree, there will be a real risk of double taxation. Many of the countries within the G20 have signed up to the OECDs proposals on binding arbitration,⁵ though how effective these prove to be in practice and how long disputes may take to resolve, remains to be seen.

Your risk of being targeted by tax authorities is heightened by the enhanced transparency brought in by CbC reporting, which will initially apply to groups with a turnover greater than 750 million Euros. The danger is that the reports are approached as simply a compliance exercise without thinking about how their disclosures might be viewed and used by the tax authorities. For example, a local tax authority could compare the headcount to the amount of tax being paid in its jurisdiction and conclude that it's missing out on its rightful share of the overall tax take.

There may be legitimate reasons why the headcount is at odds with the tax paid. For example, a dozen top designers or IT gurus in one country may generate more value than hundreds of people assembling or packing the resulting products in another location. Unfortunately, tax authorities may simply divide the tax take by the headcount and come to a different conclusion.

⁴ Draft legislation was released in China for public consultation on 16 October 2015 with a finalised version expected to be announced by the end of 2015 or early 2016. While changes are possible, all the fundamental BEPS measures as reflected in the public consultation draft will probably remain intact.

⁵ One notable exception being China.

The transfer pricing reporting changes do not have a specific threshold and many countries do not even have exemptions for small- and medium-sized enterprises. It is also worth noting that the scope of CbC reporting in future years will probably be expanded, the exemption threshold reduced, and these reports may eventually become public.

Action:

It's vital that you identify any risks in how your CbC disclosures will be assessed in each jurisdiction and proactively prepare to defend potential threats.

Shifting focus of the head of tax

While the impact of the BEPS recommendations will vary from business to business, the way you manage tax and your role within the business will change quite significantly.

1. Demonstrating substance

To demonstrate and justify that the tax being paid reflects where you've created value, there needs to be sufficient people, intellectual property generation and risk bearing capacity in the tax location. Broadly, this will shift the evaluation of tax liabilities from risks/assets to people/functions and from transfer pricing at a transaction to an enterprise-wide level.

2. From tax rate to tax risk

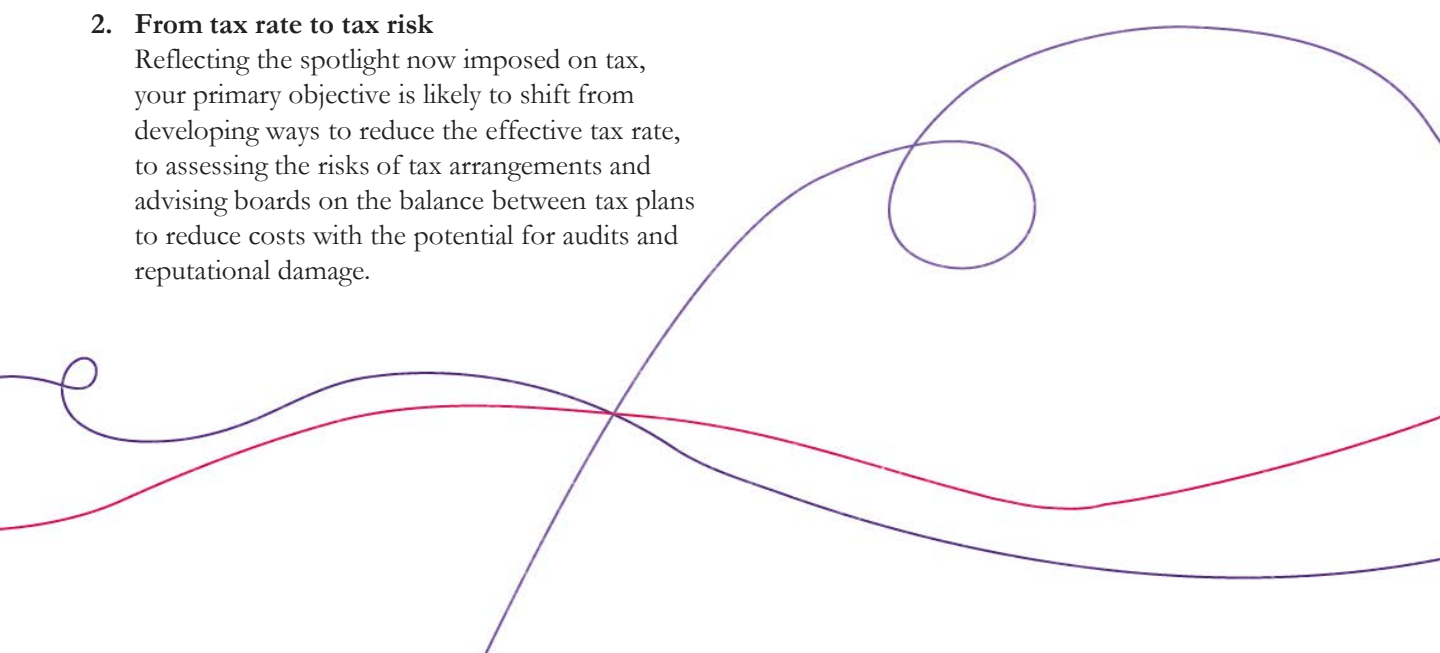
Reflecting the spotlight now imposed on tax, your primary objective is likely to shift from developing ways to reduce the effective tax rate, to assessing the risks of tax arrangements and advising boards on the balance between tax plans to reduce costs with the potential for audits and reputational damage.

The focus on substance will bring you to the forefront of strategic decision making. It will no longer be possible for business teams to plan acquisitions, operational investments and new business ventures, and then ask you and your team to make it work from a tax perspective. You will need to take an active part in these strategic discussions and decisions from the outset.

This more business-facing role is likely to require different talents and stronger engagement with the business and understanding of its markets and commercial priorities. The challenge is how you can meet these changing demands when there is often no corresponding increase in departmental budgets. This in turn underlines the importance of explaining the changes and ensuring your business understands the competitive implications.

Action:

At the very least, it's important to provide your board and business teams with regular communications about how the BEPS recommendations will affect the business' strategy and operations.



3. Taking the lead in restructuring

The need to demonstrate real substance will make it harder to justify the concentration of income for tax in jurisdictions with limited infrastructure, talent and intellectual capital. The winners are likely to be countries that can support substance, while offering a reasonably favourable tax environment for businesses to thrive and grow. The losers won't only be countries within which it is difficult to justify substance, but also those adopting aggressive tax collection strategies (e.g., wide use of punitive withholding taxes).

Companies should move quickly to assess the application of the BEPS recommendations to their transfer pricing policies and reporting requirements to ensure any risks are adequately addressed and proper planning of future transactions is undertaken

Brad Rolph

National Transfer Pricing Leader

Action:

Uncertainty over the final direction of BEPS and the wider tax regime will continue. But substance can't be changed overnight. So it's important to start planning any necessary relocation or restructuring as soon as you can.

4. New objectives and key performance indicators (KPIs)

Your objectives and KPIs will go beyond reducing the effective tax rate to include the effectiveness of risk evaluation and control.

How important will tax planning be in this new environment?

Pascal Saint-Amans, the director of the OECD's Centre for Tax Policy and Administration, believes that the BEPS project will help to make tax planning "marginal" rather than 'a core part of business models.'⁶ But no business should pay over the odds. Therefore active planning will remain a central part of your role, albeit focusing on the right location and structure rather than some of the more complex strategies seen in the past.

New regime, new role

The OECD's announcement of its finalised BEPS Action Plan is the beginning rather than the end of the journey. CbC reporting aside, it could be at least three years before we see even a measure of certainty over how the different actions will be applied in particular territories. Nonetheless, the question is how much change there will be, not least in what the business expects from you as head of tax.

Your priorities include how to manage the risks and advise boards on how the shift in international tax rules are likely to impact key strategic decisions. This will demand closer collaboration with business teams to understand where and how value is created, along with new skills and KPIs to support this. This is also an opportunity to increase influence within the business and carve out a more strategic role for you and your team.

If you would like to discuss any of the areas raised in this article, please contact your own Grant Thornton advisor or one of the contacts listed.

⁶ The Economist, 10 October 2015.

For more information, please contact

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