Client Alert | Tax

Managing The Changing Tax Landscape: The OECD's BEPS Recommendations Will Impact Every Multinational

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The global climate for international tax is rapidly changing. The OECD, the EU and tax authorities around the world have focused attention on tax planning implemented by leading multinational companies. The OECD believes that tax planning and related structures lead to an *annual revenue loss of US$100-240 billion*. Since 2013, the OECD has been leading a global initiative to attack base erosion and profit shifting (BEPS). This initiative brought together the tax authorities of over 60 countries including all of the G20, the BRICs as well as several major developing countries. Business groups and NGOs participated in an extensive consultation process. The objective of the BEPS initiative is to arm tax authorities with tools to review and attack tax planning that is perceived as aggressive and enable tax authorities to collect what they believe to be their fair share of tax. Unfortunately, the BEPS initiative also impacts commonplace tax planning and will greatly increase the burden of compliance.

On October 5, the OECD released the final version of its comprehensive BEPS package, which was immediately endorsed by the G20 on October 8. The BEPS package is a wide-ranging set of 15 Action Plans addressing every key aspect of international taxation. Some of the Action Plans include specific agreements by the participating countries to implement certain BEPS recommendations. Other Action Plans provide model legislation for countries to quickly and easily adopt in order to attack what the OECD views as abusive structures. Still other Action Plans describe best practices for tax authorities to enhance their tax enforcement capabilities. Collectively, the 15 Action Plans represent the most comprehensive multilateral effort to "level the playing field."

The BEPS package will impact key strategic decision making by every multinational company. Here are some of the immediate and medium-term actions that multinationals should be considering:

- *Country-by-country reporting* – An important agreement by the BEPS participants was the implementation of a new reporting requirement for multinationals with consolidated revenues in excess of EUR 750 million. These multinationals will now be required to provide key financial data for every subsidiary in the group on a country-by-country basis. Since this information will be shared with local tax authorities, the country-by-country report will provide taxing authorities with a first-level risk assessment and enforcement tool.

  This new reporting requirement provides further impetus for multinationals to rationalize their legal entity structures. *Multinationals should be reviewing their group structures,* evaluating their transfer pricing practices and determining where entities can be merged or eliminated in order to mitigate the compliance burdens and risk associated with this new reporting requirement. This should be an immediate action item as the reporting will become effective for the 2016 tax year.[1]

[1] Multinationals operating in the EU will also be affected by two recent decisions by the EC Competition Authority with respect to the transfer pricing methodologies used by Starbucks and Fiat. See the White & Case Alert on these decisions here.

- *Financing Structures* – Another significant BEPS Action Plan addresses financing structures using hybrid entities and hybrid instruments. The final report provides model legislation for countries to enact to address what the OECD classifies as abusive structures. Another Action Plan addresses interest deductibility and provides recommendations on deductibility caps and debt/equity ratios. Several countries (e.g., France, Germany) have already taken unilateral action in response to this Action Plan.

  Multinationals should be reviewing their intergroup and third-party financing to assess the impact of the BEPS recommendations. Multinationals should also be evaluating whether their hybrid financing structures are subject to attack and developing their audit strategy as well as alternative financing plans.

- *IP Structures* – Intellectual property is a key driver of profitability of many multinationals, and structures for developing and exploiting IP are a major factor in a multinational's effective tax rate. Several components of the BEPS recommendations address IP. At their core, the Action Plans focus on the concentration of IP-related profit in a country where the multinational has or is perceived to have minimal or no substance to support the development of that IP. The Action Plans contain agreed recommendations for attacking what are viewed as abusive IP structures. Some countries (e.g., the UK) have already implemented legislation in this regard and others (e.g., Ireland) have announced new IP tax regimes intended to be in compliance with the BEPS package.

  Multinationals with existing IP structures should be evaluating their structures in light of BEPS, particularly where the IP is being held in a low-tax jurisdiction or where there is perceived to be limited substance, and developing their audit strategies. Multinationals considering new IP structures should evaluate the operational cost of meeting the increased substance requirements as part of their overall IP planning.

- *Tax Controversies* – The BEPS process was initiated in a climate of heightened suspicions regarding the tax planning strategies of leading multinational companies. The BEPS package empowers tax authorities with new tools to attack perceived abusive tax structures and the BEPS process itself will embolden local tax authorities to be more aggressive in challenging tax positions. BEPS will result in more tax controversies and more potential double taxation as countries fight over the same tax revenue.

  Greater tax controversy resources will be required to respond to the changing environment. *Multinationals should assess their capacity for responding to an increasing number of tax audits around the world and update their risk assessments of existing exposures. Putting into place a global tax risk plan (with a focus on maintaining privilege or other protections to the extent possible) should also be high on a multinational's list of action items.*

- *Impact on Mergers & Acquisitions* – Tax is a key element in every M&A transaction. Tax is an important risk item to be assessed in due diligence and tax planning often drives the structure of an M&A deal. BEPS will change this. The risk assessment of a target company will need to factor in BEPS related issues.

  Additional resources should be directed to tax due diligence and structures used to finance M&A transactions should be reassessed.

- *Digital Economy* – One of the BEPS Action Plans was directed specifically to the digital economy. This was due in large part to the tax position of certain high-profile technology companies and much effort was directed at trying to develop alternative taxation methodologies. In the end, while much guidance was provided on the challenges of taxing the digital economy, it was recognized that special rules cannot be designed specifically for this industry. As new VAT rules are being implemented in the EU and elsewhere for e-commerce, the taxation of the digital economy will remain in flux for some time.

  Multinationals operating in the digital economy should prepare for ongoing attacks by local tax authorities as well as increasing public relations pressure regarding their tax profile.

- *Managing with Increased Uncertainty* – The OECD itself does not make law and only a limited portion of the final package contains specific commitments on agreed implementation steps. Even while the BEPS initiative was in process, several countries took preemptive unilateral action to amend tax legislation to curb perceived abuse. While 60 countries participated in the process, little consistency was achieved. With a stated annual tax gap of US$100-240 billion, it can be expected that countries will take whatever steps are necessary to collect their fair share.

  Multinationals need to be prepared for ongoing uncertainty. Tax departments should be educating management and management should be educating their boards on the impact of BEPS.

The tax position of a multinational reflects the composite tax positions in the countries in which it does business. Multinationals are under constant pressure to remain competitive, and tax is a key component of every company's bottom line. BEPS will increase that pressure significantly. Successful multinationals will be preparing for uncertainty, devoting increased resources to tax and integrating tax into their strategic planning.

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