

Taking stock on BEPS

Brad, a US citizen, comes up with a new idea and sets up BradCorp in the US to exploit it. Before anyone knows whether it is a good idea or not, BradCorp sells the rights to exploit the idea in Europe to a Dutch subsidiary, BradIP. It turns out the idea is actually a very good one, so BradUK acquires a licence from BradIP to exploit the idea in the UK.

BradUK is a clear success story, but some people are upset because the Brad Group is not paying much tax. The sale of the European brand rights was for little money – they had little value at the time – and the US is content to wait to tax the Brad Group's overseas profits as and when they are repatriated. BradUK is paying a handsome deductible licence fee – quite right too, to be able to use someone else's valuable idea. And BradIP has a ruling from the Dutch fisc confirming they are happy with the amount of tax it is paying.

So what, if anything, should be done? Should the rules be changed so that the Brad Group pays more tax? If so, whose rules? Should the UK deny a deduction unless BradIP is "fully taxed" on the licence fee? Or will that distort competition if Brad UK's main competitor gets a deduction for paying its equivalent licence fee? And is it right to deny a deduction if the fee is arm's length? Should, and indeed could, the US be persuaded to change its rules and to tax the Brad Group's overseas profit on a current basis? Should the Netherlands impose a higher tax charge on BradIP?

These are not easy questions but they are exactly the type of question the BEPS project is seeking to answer. They are fundamental questions which go to the heart of international tax co-operation and reflect a shift of focus from avoiding double taxation to not permitting double non-taxation. Those questions also illustrate the magnitude of the project. Coming up with the "right" answers to the difficult questions as to what rule changes, if any, should be made is only part 1. Part 2, and no doubt the harder part, will be to bring about those changes.

It is clear that, with the blessing of the G20, the OECD is currently in the driving seat on the BEPS project. And that is generally seen as a good thing – better to have the OECD co-ordinating an international approach than various countries trying to go it alone and creating a patchwork of misaligned rules and possible multiple taxation.

In the last year, the OECD has been busy with its two most significant publications being the BEPS Report in February, essentially a review of what they consider the problems to be, followed by the BEPS Action Plan in mid-July, what ought to be done to address them.

The Action Plan comprises fifteen detailed action points batched into three different rough timetables. Actions likely to be delivered in a 12-18 month timeframe include those looking at hybrid mismatch arrangements, treaty abuse and identifying and seeking to address the issues posed by the digital economy. The action points around the likes of CFC rules, interest deductibility and preventing the artificial avoidance of PE status are put into the two year bucket. Then there are matters such as developing a multilateral instrument to facilitate the implementation of BEPS measure and the amendment of bilateral treaties which are expected to take longer than two years.

So, realistically, what is going to happen, and when? This is proper crystal ball gazing time, because delivering on all 15 points in the Action Plan is such an ambitious project and there are so many different factors in play here. Multinationals not paying their “fair share” of tax has been front page news for several years now, in an increasing number of jurisdictions, and the media spotlight shows no sign of abating. With the number of tax justice campaign groups growing, with electorates around the world feeling the tax burden is being unfairly shifted to them and with G20 politicians having publicly pledged to “do something”, it is clear that the BEPS project is not simply going to be allowed to gather dust. Something will be done.

Equally, I would be fairly astonished if this did lead to a fundamental rewriting of international tax principles. It seems to me that although they cannot possibly say so, for fear of political and media backlash, there are probably some countries who are happy with the current system, who think they get the right amount of tax in and who might end up as losers under a new system and so will be reluctant to sign up to significant change. There are certainly countries who would not want to risk discouraging inbound investment, or worse still driving incumbent business away, by making unilateral changes. And, having watched the US debt ceiling debacle from the sidelines, good luck getting fundamental changes made to US tax rules.

So my expectation is that we will see a series of sticking plaster measures being brought forth over the next few years each aimed at making the existing system a bit more fit for purpose in the 21st century, but probably not a root and branch reform.



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