

Who will adopt the OECD's plan against BEPS, after all?

By T.P. Ostwal

Last week my fellow blogger, Mr. Theo Keijzer, in a fine [post](#) put BEPS to an acid test. The BEPS project is now reaching its moment of truth, as the ambitious deadlines and various proposals come together. The finish line is fast approaching, but while the chequered flag, podium, medals and bouquets are being readied, this last lap is sure to be a tough, sweaty slog to completion, and with the volume of work to be done.

Casting an eye over the 2015/16 Australian Budget, anyone following international tax developments over the last few months may have noticed Australia chomping at the bit to unleash new tax weapons against BEPS. After the UK legislated its diverted profits tax – known as the Google tax, the Australian government said the country “is not waiting for the rest of the world to agree to all 15 items of the Action Plan” and is now taking the next step, consistent with the directions of the G20 or OECD dialogue. Pascal Saint-Amans, director, Centre for Tax Policy and Administration at the OECD, stated, “Unilateral actions are not exactly in the sense of what we are trying to develop, and such unilateral action by countries is causing additional complexity and uncertainty.”

With US deciding not to work on the BEPS Action Plan 15 – Multilateral instrument, it seems that US is also gearing up for unilateral action to secure a mercurial part of their tax base which is prone to cross-border migration. Such actions definitely would lead to a natural tension between the interests of those countries where most multi-national companies reside (usually developed nations) and developing countries, which are more likely to be source rather than residence countries for tax purposes.

However, the current emphasis of BEPS appears to be on issues of primary concern to developed countries, such as the tax issues thrown up by the rise of the borderless digital economy. The increase in newly developed business models, e.g. through the use of a two sided business model facilitated by the digital economy, allowed the MNEs from the developed countries to even reduce their physical presence in the countries where their goods and services were being consumed. As consequence, the wide use of British Virgin Islands (BVI) like companies allowed these – mostly digital economy MNEs – to avoid paying significant taxes both in their home country (specifically developed countries) as well in their countries of destination. Although these practices have been going on for many years, i.e. following the initial emerging of electronic commerce in 1997, it took the OECD till 2005 to conclude that any usage of digital economy business configuration would not jeopardize the base concept of international taxation as laid down in the OECD Tax Model Convention. It took governments and the OECD another eight years to wake up and revisit this position.

Unlike UK and Australia, the authority of China is understood to have very positive attitudes towards the OECD's Action Plan on BEPS and attach great importance to the international community to take joint action to prevent multinational enterprises to evade taxes and transfer profits. During the period of the OECD's Action Plan on BEPS, China has already introduced a series of anti-tax avoidance regulations.

On the Indian front, activities are not clearly visible on BEPS project except becoming a signatory to the Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information. However, India expressed its “strong view” that the BEPS issues must be addressed in a manner that result in breaking down all such structures or practices that promote or protect base erosion and profit shifting. In many of the discussions and decisions at the OECD, India gathers the impression that the real issues are being swept under the carpet and the superficial ones are sought to be addressed. This approach is not going to significantly impact BEPS.

India has strongly opposed an international proposal to make arbitration binding and mandatory under the mutual agreement procedure (MAP) to resolve disputes in tax treaties. While India supports the BEPS Project, it is necessary to underline that the concerns of developing countries regarding BEPS may be different from those of developed countries. These concerns are required to be taken on board in a more consultative manner, while developing consensus on the various issues. One of the major concerns from the point of view of developing countries is regarding the approach adopted for making dispute resolution mechanisms more effective which includes introduction of mandatory and binding arbitration in the Mutual Agreement Procedure of the Tax Treaties. This not only impinges on the sovereign rights of developing countries in taxation but will also limit the ability of the developing countries to apply their domestic laws for taxing non-residents and foreign companies.

Similarly, in spite of the huge market for the digital economy in emerging economies like India, digital enterprises face zero or no taxation because of the tax treaties India has. Since the dominant players in the digital world like Amazon or Google are not tax residents in India, profits sourced from India are not offered for taxation. To ensure that the benefits of the growth of

the digital footprint across the country are reaped through higher tax collections from such activities, India has consistently made demands for source based taxation and has also suggested withholding of taxes on payments made for digital transactions. Further, to ensure that income sourced in India is taxed under the domestic laws, the domestic laws have been strengthened for taxation of royalty.

India's overall strategy in implementing BEPS must be three-fold. Any BEPS-related measure must align with, and not be disproportional to, India's domestic tax policies; the measures must not jeopardize India's obligations with its double tax avoidance agreements; the measures adopted must not only strengthen the integrity of the tax system, but also attract foreign investment. Hasty implementation of BEPS measures would undermine India's tax competitiveness compared to other emerging economies and cause a detrimental effect on the Indian economy because it would reduce the tax revenues that could be collected in the absence of BEPS. In a developing economy like India, tax revenues are crucial for reducing poverty and inequality.

While developing countries are not formally obliged to adopt the outcomes of the BEPS process, non-OECD countries have sometimes come under pressure to adopt OECD standards while negotiating tax treaties with OECD countries. Many of the international taxation rules, which have been drawn to a large extent, on the basis of the preference of the developed states to allocate greater taxation rights to the state of residence and restrict the ability of the source states to enforce their sovereign right of administering the taxes allocated to them considering the limited ability of developing countries to bargain with developed countries. In view of the inherent vulnerability of these countries in their bilateral treaty negotiations with developed countries, the United Nations needs to take a position that protects the sovereign taxation rights of the developing countries and prevent the international taxation rules from getting unjustly skewed in favour of the developed countries. In particular, the United Nations needs to take the interest of the developing countries and the base erosion and profit shifting faced by them into account while carrying out work on BEPS.

Conclusions

As it stands today, the G-20/OECD's biggest challenge is "keeping the consensus" going on international tax principles amongst the countries participating in the BEPS project. If G20/OECD cannot secure the delicate balance between its members, the following "worst case scenario" should be anticipated.

A. In the absence of consensus within G20/OECD, most countries will introduce unilateral BEPS measures which will seriously impact the tax risks of MNEs—"the war scenario".

B. If a majority of countries buys into the G-20/OECD BEPS measures, a cohort of outliers such as the U.K., Australia, China and India will create at least two standards of international tax and TP principles—"the semi-consensus scenario".

As a consequence, the OECD will run the risk of losing its position of being the only "consensus platform". The UN, World Bank, IMF and EU are already adopting initiatives which appear to compete with the G-20/OECD to combat "tax leakages" and satisfy the aggressive language used by politicians. This means that the consensus carefully built by the OECD over a more than 50 year period is being destroyed in a period of 24 months. The OECD's BEPS project is in its final lap with no chequered flag in sight!

(Views expressed are personal and not necessarily of the firm)

(Shreyash Shah assisted the author to this article)

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