Analysis

The US response to the final BEPS report

Speed read

Although generally supportive, the United States has been more sceptical of the BEPS process than many of the other participants. This stems partly from the current US political environment and partly from a perception that BEPS is focused on US multinationals. The US expects to adopt some of the reporting and documentation requirements of BEPS, including country by country reporting. Although broad changes have been proposed with respect to transfer pricing, the US has taken the position that few or no changes in its domestic law will be necessary because existing rules are generally consistent with the BEPS proposals.

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The United States' response to the BEPS 2015 final report released on 5 October varies depending on whom one asks: Congress, the Administration or the private sector. Broadly speaking, representatives from both branches of government have been sceptical of the BEPS process. This presumably stems from a general impression that the BEPS initiative originated, at least in part, from the desire of foreign governments to capture more tax revenue from US-based multinationals. Some legislators are openly hostile. US Treasury representatives are more cautious in their criticisms, not wanting to openly oppose the developing international consensus and wanting to retain a seat at the table as new norms of global taxation evolve.

The Treasury believes that, in general, the current US rules are consistent with many of the BEPS reports' recommendations. In those limited areas where the Treasury concedes inconsistency and has the authority to act, implementation is expected to proceed at a cautious pace. For example, in May, the Treasury released proposed BEPS-related revisions to the US Model Tax Treaty to address (and influence) the final BEPS reports. The Treasury hopes to finalise these by the end of the year; however, it acknowledges that it does not have the authority to adopt all of the BEPS recommendations without legislation. Key tax-writing members of Congress have expressed both frustration with their lack of involvement with the BEPS project and their general opposition to its recommendations. This has led them to challenge the Treasury's authority to issue guidance on what would seem to be purely regulatory matters, such as rules implementing country by country reporting (CBC).

Action 1: Digital economy

The Action 1 report analyses the tax challenges posed by the growth of the digital economy, repeating some recommendations made in other Action items. Action 1 also describes rules and implementation mechanisms that will enable efficient collection of VAT in cross-border transactions. US officials have said little about this Action item publicly. (Their response to the key permanent establishment (PE) recommendations is discussed under Action 7 below.)

Action 2: Hybrid mismatch arrangements

Action 2 provides detailed recommendations to neutralise the effect of hybrid mismatch arrangements that produce multiple deductions for a single expense, or a deduction in one jurisdiction with no corresponding income inclusion in another. Although many of these hybrid mismatches result from the US's elective entity classification regime and substance-over-form rules, US officials have said little publicly beyond vague, generally supportive (but non-committal) comments.

Action 3: Controlled foreign companies

The Action 3 report contains a number of recommendations for implementing controlled foreign company (CFC) regimes and making existing CFC regimes more effective. This approach reflects a lack of consensus among the participants. Treasury officials have expressed their disappointment with this report. Various proposals to modify the US CFC rules have been put forth in recent years, but taxpayers, the Treasury and some in Congress worry that unilaterally imposing stricter CFC rules would harm the competitiveness of US multinationals. Thus, the likelihood of congressional action any time soon remains low.

Action 4: Limiting interest deductions

Action 4 provides a range of recommendations for limiting interest deductions, including limits based on EBITDA and worldwide group interest limitations. This approach reflects the lack of consensus among participants. Although generally supportive, Treasury officials have expressed disappointment with the lack of consensus, and concern that worldwide limitations may encourage multinationals to locate all borrowing in their US affiliates. Numerous proposals for legislation to limit interest deductions in recent years have gone nowhere.

Action 5: Countering harmful tax practices

The Action 5 report provides criteria for identifying harmful tax practices, particularly patent boxes. Action 5 also supports the compulsory exchange of certain tax rulings. US officials have expressed general support for the increased transparency that will come with exchanging tax rulings, and have publicly stated that the US intends to participate in the exchange of such rulings – though there is some question regarding the Treasury's authority to do so in the absence of legislation, particularly in the case of existing advance pricing agreements. The recently proposed US Model Treaty revisions would deny certain treaty benefits where preferential tax regimes are present, capturing a concept similar, but not identical, to that addressed by Action 5. Some of the patent box type regimes

proposed in Congress in recent years appear to be inconsistent with the nexus requirements of Action 5.

Action 6: Preventing treaty abuse

Action 6 proposes revisions to the OECD Model Tax Convention to require the inclusion of an objective limitation on benefits (LOB) clause, a subjective principal purpose test (PPT) or both. The US strongly favours LOB clauses and objects to a PPT because of its subjectivity. Because US treaties already include LOB clauses, the US is unlikely to amend existing treaties or to agree to include a PPT in future treaties. Indeed, the recently proposed revisions to the US Model Treaty modify only slightly the existing LOB provision.

Action 7: Permanent establishments

The final report on Action 7 revised the definition of a PE in the OECD Model Tax Convention, but scaled back the proposed expansion of the previous draft. (For example, the final report says a PE exists where a person acting on behalf of an enterprise habitually plays a principal role in the conclusion of contracts, whereas prior drafts had referenced the mere negotiation of material aspects of contracts.) These changes have been praised by Treasury officials, who had argued that prior drafts could have been interpreted too broadly, leading to confusion. However, some officials feel the final language may still be too broad. Treasury officials have also expressed disappointment that Action 7 did not address the rules regarding the attribution of profits to PEs. The final report also introduces an anti-fragmentation rule, however, which Treasury officials have generally supported.

Actions 8, 9 and 10: Transfer pricing

Actions 8, 9 and 10 revise the OECD transfer pricing guidelines regarding risk and recharacterisation, commodity transactions, intangibles, cost contribution arrangements (CCAs) and low-value services, and call for further work on the profit split method. Treasury officials do not envision significant changes to US transfer pricing regulations, arguing that the final report simply clarifies the arm's length standard already embodied in the existing regulations. The US disagrees with the view, held by some OECD countries, that the return earned by funding entities with investment risk but not operational risk should be limited in all cases. The US is also reluctant to push taxpayers toward profit split methods, believing that existing transfer pricing models using valuation methods and comparables generally suffice.

Action 11: Data analysis

This report attempts to quantify the scale and effect of BEPS and makes recommendations for improving the quality and reporting of data and analysis concerning BEPS. The reported data would include aggregated information collected through CBC reports, as well as information already available to tax administrators. US officials have not publicly objected to such anonymised data compilation and analysis.

Action 12: Mandatory disclosures

Action 12 provides a framework to help countries without mandatory disclosure rules to design regimes to obtain early information on potentially aggressive or abusive tax planning schemes. The recommendations are not minimum standards, and countries may choose whether or not to introduce such regimes. Because the US already has rules requiring taxpayers to self-report certain types of ('reportable') transactions and uncertain tax positions, it seems unlikely the US will adopt significant changes in response to Action 12. US officials have said very little publicly about this report, however.

Action 13: Transfer pricing documentation

Action 13 requires taxpayers to provide high-level 'master' files and detailed transactional transfer pricing 'local' files to the relevant countries, as well as CBC reports annually for each tax jurisdiction in which they do business. CBC reports will include revenues, employees, assets and entities in each jurisdiction. Despite objections by some in Congress, the Treasury has asserted its authority to impose CBC on US taxpayers and to exchange such information with other countries. Regulations implementing CBC are expected to closely track the Action 13 report, and are due out by the end of the year, so 2016 data can be reported in 2017. US officials have stated that the US will suspend information exchange with countries that misuse or publicly leak data taken from CBC reports, and are particularly concerned about tax administrators making assumptions about allocable profits based on items like employee head counts. The Treasury has been less forthcoming with details about how (or if) it will implement the master and local file approaches, leading some members of Congress to express concerns.

Action 14: Dispute resolution

Action 14 developed a minimum standard and (optional) best practices intended to strengthen the efficacy of the mutual agreement procedure (MAP) process. Twenty countries (including the US) listed in the final report also committed to including mandatory binding arbitration in their tax treaties, which the US strongly supports and (unsuccessfully) sought to have included. The US expects acceptance of mandatory binding arbitration to grow, as it is generally efficient and cost effective. Because some countries (notably India) remain staunchly opposed, US representatives do not expect binding arbitration to become a minimum standard anytime soon.

Action 15: Multilateral instrument

The Action 15 report explored the technical feasibility (and endorsed the development) of a multilateral instrument that would enable countries to voluntarily implement BEPS project measures by amending existing bilateral tax treaties through a single instrument. This is intended to avoid the renegotiation of each treaty. The US did not participate in Action 15 (citing resource constraints) but recently announced that it would participate in the development of a multilateral instrument, principally to advance mandatory binding arbitration for dispute resolution. The Treasury has conceded that congressional involvement is necessary, however, and has stated that its decision to participate does not necessarily mean the US will sign the multilateral instrument.

Practice points

UK practitioners representing US multinationals should be prepared for the immediate impact of CBC. US multinationals' non-US operations will also be affected, irrespective of US views, because other countries will implement BEPS Action items. US multinationals' principal concern is that inconsistent implementation will result in increased uncertainty and more disputes. Additional compliance costs are a given. ■

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