Special report

Assessing the impact of BEPS on business

Speed read

A survey of senior in-house tax experts, by *Tax Journal* in association with FTI Consulting, assessed the impact to date of the OECD's BEPS recommendations on large businesses. More than 100 large organisations took part. A majority of respondents agreed that BEPS would lead to a more sustainable, uniform global tax system. However, there were concerns over increased compliance cost, double taxation, inconsistency of implementation by different countries and an increase in tax disputes. A key issue for many businesses concerns Action 7 on permanent establishments, with more than half of survey respondents expecting a risk that their group would be deemed to have one or more PEs in a foreign jurisdiction.

Senior in-house tax experts from more than 100 large businesses took part in a survey by *Tax Journal* and FTI Consulting, in late 2016, to give their views on the initial impact of the OECD's recommendations on tackling base erosion and profit shifting (BEPS). Respondents came from a variety of industries, with about a fifth from finance, a tenth from real estate investments and services, and a tenth from the travel and leisure industry.

BEPS and group tax impact

Some 60% of respondents agreed that the BEPS project would create a more sustainable, uniform global tax system, while 22% disagreed; and a third said their group had been actively involved in responding to BEPS-related guidance (such as OECD draft proposal documents).

Despite this, there were concerns. 'BEPS made more progress than expected, but without additional resource at the OECD it will stall,' one respondent said. 'The piecemeal implementation of BEPS recommendations around the world is not ideal and it significantly increases the compliance burden and double tax risk.'

> 'The key challenges and concerns are: increased compliance costs, potential re-emergence of double taxation, confidentiality ... and the increased risk of tax position uncertainty'

Concerns over inconsistent implementation of BEPS was a recurring theme among several respondents. 'I'm not confident that all countries will implement BEPS and in the same timeframe,' said one tax director. 'Without this, any success is questionable.' Another agreed, saying that 'ultimately, how successful the BEPS project is in meeting its own objectives will depend on the extent of US participation.'

'The key challenges and concerns are: increased compliance and administration costs, potential re-emergence of double taxation, confidentiality and the use of our sensitive information and the increased risk of tax position uncertainty,' said another.

'BEPS was intended to increase global consistency in tax authorities' approach to taxation of MNEs,' said one respondent. 'In practice, this has gone the other way: countries have introduced ad hoc new taxes, the new permanent establishment (PE) rules are accepted by some countries and not others, even though these countries may be bilateral treaty partners, and interest rules are being interpreted differently in different jurisdictions.'

Over half of our survey respondents expected an increase in the incidence of double taxation within the respondent's group's tax as a result of BEPS, with 17% saying it was 'very likely' and 36% thinking it 'somewhat likely'. While 54% did not anticipate hybrid mismatch arrangements would have an impact on their business, just over half (51%) expected some sort of increase on their group's effective tax rate as a result of BEPS, although a quarter said the effect on their ETR could not be known at present.

'Double taxation, or more correctly multiple taxation, can result from BEPS actions,' one respondent said. 'There should be an "anti-abusive" or "anti-aggressive" package for tax officers or countries that abuse their powers.'

Interest deductions, patent box and permanent establishment

Two-thirds of respondents had at least started some preparation for the implementation of BEPS Action 4 on interest deductions, with 19% saying they were fully prepared. However, only 27% of respondents to our survey were considering refinancing or altering the mix of external and internal debt/equity ratio as a result of Action 4.

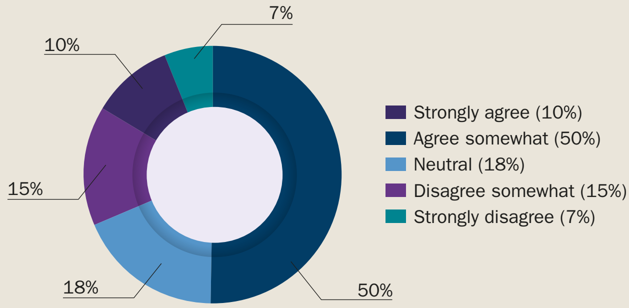
Regarding how the UK patent box changes, as a result of BEPS, would impact the group companies surveyed, almost all replied that the changes were either not relevant (60%) or would have no impact (37%).

> More than half of the respondents expected that there would be a risk that their group would be deemed to have one or more PEs in a foreign jurisdiction

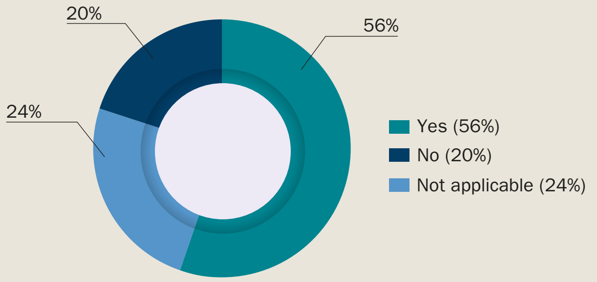
With one respondent confirming that 'a major challenge for us is the risk of new permanent establishments' and another saying PE changes were 'a significant issue', BEPS Action 7 on PEs seemed to cause much greater concern than interest deductibility (although it should be noted that the survey was conducted before the recent publication of the UK's draft legislation on this issue). While a quarter answered that Action 7 was not applicable to them, more than half of the respondents (56%) expected that there would be a risk that their group would be deemed to have one or more PEs in a foreign jurisdiction. A similar number (51%) said it was likely or highly likely that they would seek external confirmation from advisers that their foreign operations do not create a PE in that jurisdiction, while 39% said they were considering changing their group's operating model in order to manage increased PE risk as a result of Action 7.

Commenting on the findings, Marvin Rust, head of tax at FTI Consulting, said: 'One of the striking findings, which also reflects what we are currently seeing in the market, is that following the changes to the PE definition recommendation by Action 7, most respondents expect to have more PEs. This is also consistent with the statement

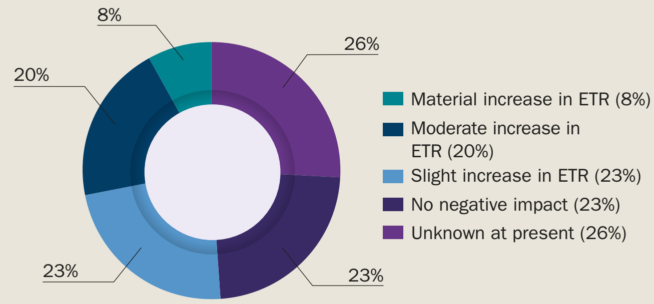
Do you agree that the BEPS project will create a more sustainable uniform global tax system?



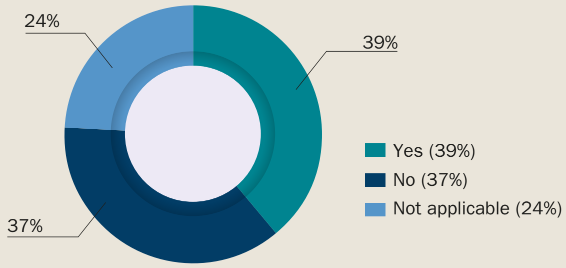
Do you expect that following changes recommended by BEPS Action 7 to the permanent establishment definition, there is a risk that your group would be deemed to have one or more additional permanent establishments in a foreign jurisdiction?



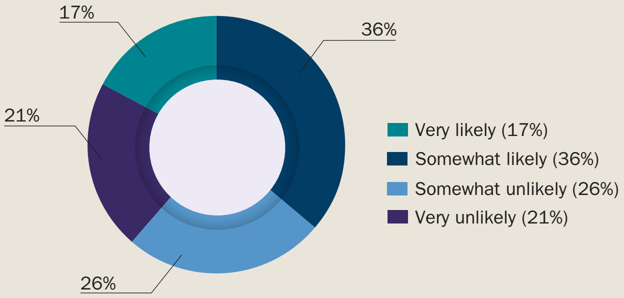
How do you currently see the impact of BEPS on your group's ETR?



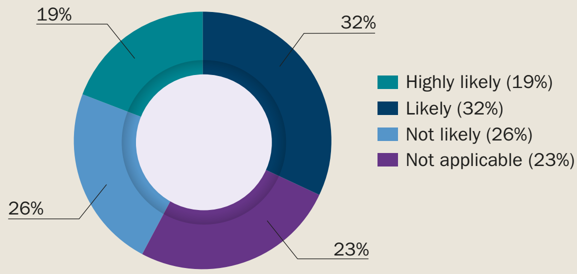
Are you considering changing your group's operating model in order to manage increased permanent establishment risk resulting from BEPS Action 7?



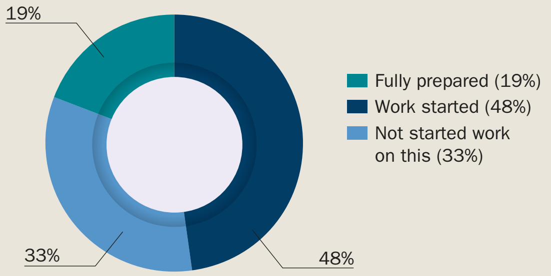
Do you expect an increase in the incidence of double taxation to occur within your group as a result of BEPS Actions?



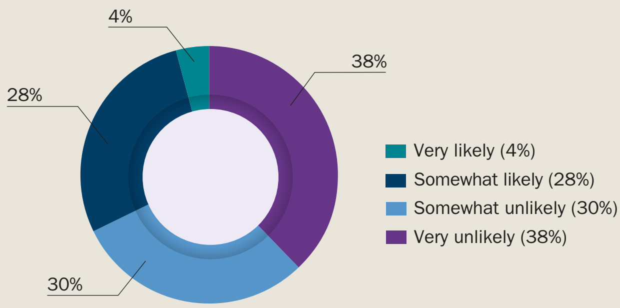
If your company has business operations in a foreign jurisdiction, are you seeking external confirmation from advisers that these operations do not create a permanent establishment there?



To what extent is your group ready to implement BEPS Action 4 in relation to interest deductions?



In light of the changes in the OECD's guidance for transfer pricing from BEPS, how likely is your organisation to make operational changes, e.g. to move personnel to increase economic substance?



made by the co-chair of the OECD's WP6 during the public consultation on Action 7 held at the OECD consultation on 11 October [2016], in which we participated. Specifically, he said: "The threshold for PEs has now been agreed at a high level, but it paramount to businesses and tax authorities ... to apply that [threshold] consistently [to] what we believe ... will be a substantial increase in the number of PEs." It is therefore logical that the vast majority of respondents who expect additional PEs are considering changing their group's operating model.'

Operational issues, reporting, and disputes

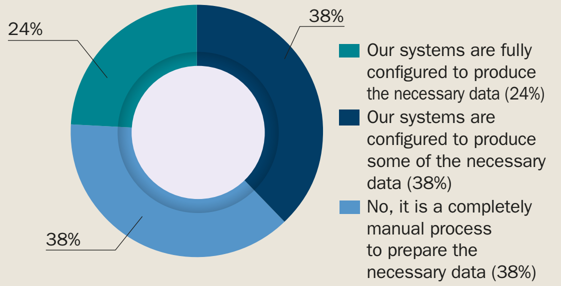
Given that the financial capacity to assume risk and the ability to control risk were key concepts of the guidance under BEPS Actions 8–10, most respondents were either very comfortable (26%) or moderately comfortable (54%) that their organisation can determine whether an entity meets the OECD's new requirements in relation to control and risk on an entity by entity basis.

The majority of respondents were unlikely to make operational changes (for example, moving personnel to increase economic substance) in light of the changes in the OECD's guidance for transfer pricing: 30% said it was somewhat unlikely and 38% said it was very unlikely they would.

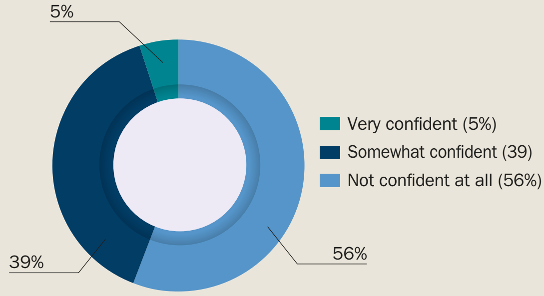
Over three-fifths (62%) said their organisation's systems were configured to produce at least some of the necessary data required for country by country reporting (CBCR) and the preparation of transfer pricing local files. For groups with consolidated revenue of €750m or more, 29% said their senior management was 'moderately involved' in reviewing the master file, and the same number answered that the master file was the responsibility of the tax team but senior management wasn't involved.

> Two thirds (67%) of respondents expect to change their approach to tax planning for cross-border transactions as a result of BEPS

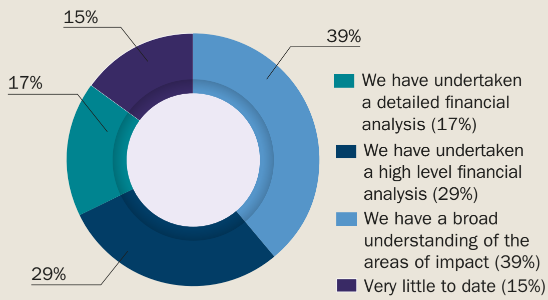
Does your organisation have the systems capability to produce the information required for country by country (CBC) reporting and the preparation of transfer pricing Local Files?



How confident are you in the effectiveness of the proposed mutual agreement procedure (MAP) mechanism under Action 14 to resolve disputes with tax authorities?



What level of work has your group undertaken to date to determine the impact of BEPS?



'One of the key issues/changes we have faced as a group is a change in the burden of risks and responsibilities for the tax reporting,' one respondent explained. 'We are a subsidiary group of a foreign MNE, with a UK sister group that operates relatively independently. As two UK groups under common control, we are viewed as one under some sections of the new interest deductibility calculations and CBCR. The result is that we are largely reliant on our non-UK shareholders for the information and calculations necessary under the interest deductibility, and CBCR. This results in a situation where a UK subgroup bears the responsibility and risk of penalties but is reliant on a foreign company, albeit the parent, for the information to report.'

Another respondent cited that their organisation's main concern was 'cost, particularly of data gathering for the CBCR template', while another said BEPS would result in 'much more of a compliance burden, and more tax authority enquiries are expected'.

'Our key challenges thus far have been configuring financial systems/processes for CBCR and dialogue with the business regarding tougher substance standards', one said of their organisation's operational issues. 'The BEPS project already has to be seen as a success, but there are still challenges regarding work on the financial services sector and the US take up of BEPS.'

Some 56% answered that they were not confident at all in the effectiveness of the proposed mutual agreement procedure (MAP) mechanism under BEPS Action 14 to resolve disputes within tax authorities. 'We're less likely to do MAP as we believe tax authorities will be so overwhelmed with more claims from larger entities than ours. They'll decline as we won't represent enough of a risk of tax loss in comparison,' one said, 'so we'll be left carrying the burden, uncertainty and cost.' Another observed that a 'binding MAP and dispute resolution procedure is mandatory to avoid double taxation as result of BEPS'.

Cross-border and transfer pricing issues

Two thirds (67%) of respondents expect to change their approach to tax planning for cross-border transactions as a result of BEPS: with 46% having already made changes, and a further 21% likely to do so in the near future.

In the light of the changes in the OECD's guidance for transfer pricing from BEPS, 62% said they were either very likely (29%) or somewhat likely (33%) to review and amend their group's transfer pricing policies; although 61% said they were no more likely to pursue additional binding agreements such as advance pricing agreements or thin capitalisation agreements, despite perceived uncertainty from BEPS.

Overall concerns

A minority (15%) of respondents have done 'very little work to date' to determine the impact of BEPS. Encouragingly, 39% said they have at least a broad understanding of the areas of impact on their group, while 29% have undertaken a high-level financial analysis and 17% have performed a 'detailed' one.

An overwhelming majority (64%) said that they were not likely to undertake a group-wide business transformation, although 13% were likely or very likely to do so. One respondent confirmed: 'We commenced restructuring in anticipation of the BEPS changes and with awareness that our previous models were not robust in 2014 [and] completed a major business transfer with effect from 1 January 2016.'

Certain BEPS papers have increased the compliance burden on companies, as well as creating additional work from revisiting policies. 'Overall I feel [BEPS] will lead to an increased compliance burden for some immeasurable benefits,' opined one. Nevertheless, 59% did not see their tax team expanding in the coming year to handle the changes. A fifth, however, confirmed that they needed external support to augment their team.

'There won't be enough coordinated approach between jurisdictions ... Anyone for BEPS2 in 2025?'

Encouragingly, a majority of businesses were at least mostly ready for BEPS compliance: 54% deemed themselves ready in most areas, and 12% said they were ready in all areas. However, 28% said they were not ready in most areas. One cited 'uncertainty around detailed working of some of the BEPS plans on the investment management industry', while another cited their concern around BEPS Action 6 on holding companies for private equity investments. Another said: 'Raising awareness of this in my organisation is slow, mostly due to a long-term lack of awareness of tax and all the other tax changes currently underway.'

Many respondents felt the biggest problem that the BEPS project could run into concerned the lack of consistency among countries on implementation of the recommendations. 'The main issue is uncertainty whilst some countries implement and some don't, and we therefore need to analyse multiple sets of rules for a number of years without knowing what positions tax authorities will end up taking, post-case law,' one said. 'As a result, the intended outcome may not be achieved in practice, albeit that the rules may be as intended.'

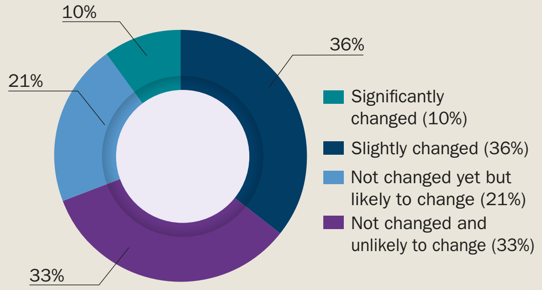
A second respondent said: 'Pre-emptive actions by states (not BEPS directly) adds to uncertainty, as well as different levels of adoption of BEPS actions. Also less well-developed countries under the UN model have a different perspective.' A third added: 'While US, China and Russia remain unconvinced, it is hard to see the aims of BEPS being met. In addition, you have the EU and others introducing their own rules above and beyond BEPS.'

'Any anticipated benefit to tax authorities and other stakeholders in terms of anti-arbitrage or disruption of genuine BEPS activities is unlikely to be of a quantum to justify the significant additional compliance burden imposed on all non-SME international businesses by the project's recommendations,' said another.

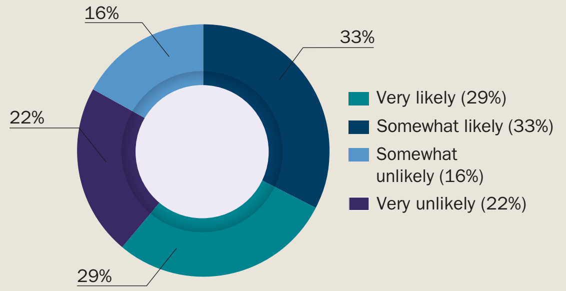
Meanwhile, one wrote the BEPS project may well have to be rethought at a later date: 'With CCCTB re-emerging and the ATAD, there is one positive outcome of Brexit! My personal view on BEPS is that there won't be enough coordinated approach between jurisdictions. Every country being allowed to implement the package (or parts of it), plus some unilateral measures (such as the diverted profits tax) will lead to a fragmented global tax system. Anyone for BEPS2 in 2025?' ■

The full report, with details of the FTI team involved, is available to download at ***www.taxjournal.com/BEPSreport****. For more on FTI, see www.fti.tax.*

To what extent has your business changed its approach to tax planning for cross-border transactions as a result of BEPS Actions?



In light of the changes in the OECD's guidance for transfer pricing from BEPS, how likely is your organisation to review and amend its transfer pricing policies?



Certain BEPS papers have increased the compliance burden on companies, as well as creatingSW work from revisiting policies. Do you see your tax team expanding in the coming year to handle these changes?