12. The BEPS Action Plan - Update

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Introduction

In July 2013, the OECD released its long awaited action plan on Base Erosion and Profit Shifing (BEPS)[1]. The plan, which consists of 15 actions to be undertaken between September 2014 and December 2015, aims at fixing rather than changing international corporate tax law. In essence, the measures are based on three core principles, i.e. coherence, substance and transparency. The coherence principle seeks to avoid double non-taxation situations stemming from domestic and/or treaty law differences or mismatches. The substance principle, which pertains to the work to be undertaken in the area of harmful tax competition, tax treaties and transfer pricing (TP), is designed to reconcile taxation in accordance with economic substance and income allocation with value creation. Finally, as transparency is essential, the plan contemplates the development of recommendations regarding the design of mandatory disclosure rules for aggressive tax planning transactions.

At the European Union (EU) level, the EU Commission has taken cognizance of the BEPS action plan and has launched comparable initiatives. As shown in the following table, the work undertaken by the OECD and the EU in the international corporate tax avoidance arena is "holistic" in nature. Technically, the plan may affect rules concerning (i) jurisdiction to tax (ii) the determination of taxable basis (iii) harmful tax competition and (iv) implementation measures.

Field	BEPS Action Plan	EU
Jurisdiction to tax	Action 1: Digital economy (9.2014); Action 3: CFC rules (9.2015); Action 6: Treaty abuse (9.2014); Action 7: Artificial avoidance of PE status (9.2015)	Digital economy expert group (ongoing since 10.2013)
Taxable basis	Action 2: Hybrid mismatches (9.2014); Action 4: Limitation on interest deductions and other financial payments (9-12.2015); Actions 8, 9, 10 and 13: transfer pricing (9.2014 to 9.2015)	Code of conduct and proposed amendment to parent sub directive re hybrid arrangements (11.2013)
Harmful tax competition	Action 5: (9.2014 - 9-12.2015); substantial activity requirement (review of patent box regimes in particular)	Code of conduct (review of patent box regimes by the end of 2014) and minimum standards of good governance in tax matters regarding third States State aid (in particular further impact of Gibraltar II?)
Implementation	Action 11: Data on BEPS (9.2015); Action 12: Mandatory disclosure of aggressive tax planning arrangements (9.2015); Action 14: Dispute resolution (9.2015); Action 15: multilateral instrument (9.2014-9.2015)	

At the same time, the question arises as to whether EU law may represent a roadblock for the BEPS action plan execution. Thus, the compatibility of the BEPS action plan with EU taxation principles, in particular, the fundamental freedoms will have to be addressed. This tension concerns inter alia the definition of abuse, territorial restrictions, which are prohibited under the fundamental freedoms as well as the principle of non-discrimination.

The BEPS action plan is of paramount importance to Switzerland. Moreover, Switzerland not being a member of the EU, it is in its interest to achieve, as much as possible, an equal level playing field among all OECD countries. The third corporate tax reform, the consultation of which is scheduled to begin at the end of the summer, will have to comply with these new international standards in order to ensure legal certainty on a long term basis. Of concern to Switzerland is in particular the work undertaken in the area of harmful tax competition, treaty abuse and transfer pricing.

Harmful Tax Competition

In essence, the work of the OECD and the EU now looks as to whether, and if so to what extent, a particular preferential regime is associated with a substantial activity in the relevant jurisdiction. This criterion is, in particular, relevant to patent box regimes which are currently being reviewed. At the time of writing of this contribution, three main approaches are being (or have been) considered: (i) a traditional transfer pricing approach that focuses on important functions; (ii) a value creation approach which would require significant development activities and (iii) a nexus approach that requires tax benefits to be connected directly to R&D expenditures. Under the latter approach, the patent box regime would depend on the expenditures incurred by the entity as compared with those borne by other associated enterprises in relation to the development of the qualifying intangible. From a policy perspective, this approach seeks to ensure that a patent box regime effectively leads to actual and additional R&D activity in the relevant jurisdiction[2].

Yet, this line of reasoning, if it were to be confirmed, could affect IP structures involving outsourcing of certain R&D functions by the patent box entity to other associated enterprises. Similarly, under the substantial activity criterion, the application of a patent box regime to acquired IP (not being further developed) may be problematic. The results relating to the review of patent box regimes are to be released in September 2014. Similarly, at the EU level and further to the 2013 December ECOFIN meeting, all European patent box regimes are to be reviewed by the end of the year. Last but not least, the question of whether patent box regimes may be regarded as conferring a prohibited de facto selective advantage under EU State aid rules[3] is capturing increasing attention. Indeed, as mentioned by the Commission at the end of March, this could hold true if it is established that patent box regimes de facto only benefit international mobile enterprises without creating a genuine research and development activity in the relevant State. The Commission is gathering information to determine whether this is the case[4]. In our opinion, this development does not come as a surprise as it is in line with the recent case law of the ECJ in the area of State aid rules[5].

For Switzerland, the combined effect of the foregoing developments is clear: Any patent box contemplated by the third corporate tax reform would only be viable on the long run if it is structured as a genuine incentive in favor of R&D. Accordingly, the regime should be made conditional on the exercise of a qualifying substantial R&D activity by the privileged entity. Secondly, the definition of privileged IP rights, which should be consistent with the alleged purpose of the incentive, should primarily focus on trade intangibles (restrictive catalogue). Finally, State aid rules, which the EU considers to be applicable to Switzerland through the 1972 Free Trade Agreement, should be borne in mind. Therefore, the proposed regime should apply as widely as possible to all enterprises, irrespective of whether the latter have a domestic or international activity and regardless of their legal form (legal entity or partnership). Similarly, access to the patent box should not be de facto restricted to some enterprises.

Transfer Pricing

Action 8 calls for rules to be developed to prevent BEPS by moving intangibles to members of a multinational operating in low tax jurisdictions. The BEPS action plan proposes to enhance the definition of intangibles, ensure appropriate allocation of profits with value creation and develop TP rules for transfer of intangibles. The OECD had already issued a draft report on July 30th, 2013, to discuss the foregoing. Interestingly, the draft contains several examples which outline the taxpayer to whom intangible returns should be attributed. Several examples highlight that profits are attributed to a member of a multinational on the basis of functions performed, assets used, and risks assumed with respect to the intangible as opposed to mere legal ownership. Indeed, the OECD seems to align profits with value creation - an approach that is also being contemplated to counteract harmful tax competition vis-à-vis patent box regimes. The changes may impact a variety of Swiss IP ownership structures.

Transparency in tax matters ranks at a high pedestal on the OECD's tax agenda. Over the past few years, the exchange of information standard has been substantially modified and Switzerland has changed its approach to this standard. With respect to TP, the BEPS Action plan proposes to re-examine TP documentation requirements to ensure transparency for tax administrations. The plan proposes to create rules for multinationals to provide the relevant governments with information on their global allocation of the income, economic activity and taxes paid among countries pursuant to a common template. In its white paper on TP documentation released on July 30, 2013, the OECD had proposed formats to provide tax authorities with a "big picture" of a multinational's financial information that will be useful in connection with transfer pricing audits. A two-tiered approach was suggested which included the preparation of a detailed global master file and country specific local files. Subsequently, after a public consultation, the OECD released a discussion draft on TP documentation and country by country (CBC) reporting in accordance with Action Plan 13. The documentation requirements are similar to those suggested in the white paper. On the other hand, the CBC standard requires MNC's to disclose variety of information, in particular details about the taxes paid, number of employees, tangible assets, in each jurisidiction in which a multinational operates. In our view, the OECD's objective of CBC is welcome. However, there is an inherent risk that such information will lead to a dilution of the arms length principle as tax authorities may be tempted to make adjustments more in line with a formulary apportionment type of system. These developments may impact principal/hub structures operated from Switzerland.

Treaty Abuse

On March 14, 2014, the OECD published its first report to counter treaty abuse. The report proposes significant changes to the OECD Model and Commentary. Notably, the emphasis is on addressing treaty shopping situations wherein residents of third States attempt to access an existing bilateral tax treaty framework. As counteraction tools, the report proposes an inclusion in the title and preamble of a clear statement that treaties are not intended to create opportunities for non or reduced taxation through tax avoidance and evasion, a US style limitation of benefit clause and a main purpose general anti-abuse rule that is similar to the guiding principle found in the OECD Commentary on Article 1. Further, a variety of amendments and targeted anti-avoidance rules are proposed to counteract artificial reduction/elimination of source country withholding tax on dividends, aggressive tax planning through dual resident corporations and potential abuses that may result from transferring mobile assets to low taxed permanent establishments (PE). With respect to anti-abuse rules for low taxed PE's, the draft proposes rules to deny relief from source country withholding taxes on payments to a PE if the combined rate of tax paid by the recipient in the PE and residence countries is less than 60% of the tax rate of the residence country. Nonetheless, exceptions are provided if the PE engages in IP development or is engaged in active conduct of trade or business. Moreover, it is proposed that the OECD Commentary is amended to clarify that, in general, domestic general and specific anti-abuse rules do not conflict with tax treaties. In this context, the so-called US savings clause is proposed to be incorporated, which negates the argument that a tax treaty prevents the application of controlled foreign company rules. In our view, if the proposals are widely adopted, they will certainly reduce treaty abuse but at the same time create uncertainty for taxpayers operating in a global enviroment. From this perspective, these proposals, in our view, still need to be further refined.

1) For a more detailed discussion see Robert Danon, La refonte de la fiscalité internationale des entreprises, Analyse des possibles incidences pour la Suisse au regard de questions choisies, IFF Forum 2014, p. 16 et ss.
2) https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/293742/PU1651_BEPS_AA_-_FINAL_v2.pdf
3) Art. 107 et seq. TFUE
4) http://europa.eu/rapid/press-release_IP-14-309_en.htm
5) See thereupon Robert Danon, Introducing an EU Compliant Patent Box Regime in Swiss Tax Law, in: Daniel Sarmiento, Domingo Jiménez-Valladolid de L'Hotellerie-Fallois (ed.), Litigating EU Tax Law in International, National and Non-EU National Courts, 2014, p. 269

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