



TECHNICAL UPDATE

INTERNATIONAL PROFIT SHIFTING AND TAX EVASION – AUSTRALIA AND OTHER G20 NATIONS AGREE TO IMPLEMENT OECD BEPS INITIATIVES

THE INTERNATIONAL TAX PLAYING FIELD IS SET TO CHANGE DRAMATICALLY IF THE OECD INITIATIVES ARE IMPLEMENTED TO ADDRESS BASE EROSION AND PROFIT SHIFTING (BEPS).

On 20 September 2014, Federal Treasurer Joe Hockey announced that Australia and the other G20 Nations have confirmed their commitment to tackle BEPS as they unanimously agreed in 2013. The OECD has been working on the 15 point BEPS project and on 16 September 2014 provided interim reports on seven of these initiatives. In his announcement, Joe Hockey also committed to Australia implementing the proposed country-by-country reporting standard for transfer pricing in 2017.

The country-by-country reporting standard will require taxpayers with international related party transactions, to make available reports to the participating revenue authorities on the financial arrangements in each of the countries they and their related entities operate in. This will provide the Australian Taxation Office (ATO) and other participating revenue authorities with a far greater understanding of where the business activities and profits are being conducted and made and is likely to make it more difficult for multi-national entities to shift profits to lower tax countries. However, these enhanced reporting requirements are also likely to greatly increase the compliance burden for the affected taxpayers.

BDO International conducted a webinar on 2 October 2014 to discuss the proposed country-by-country reporting standard. Please click [here](#) to view the webinar.

The BEPS Project aims to create a single set of consensus-based international tax rules to address BEPS, and hence to protect tax bases while offering increased certainty and predictability to taxpayers. A key focus of this work is to eliminate double non-taxation.

Our summary of the seven BEPS initiatives which were provided on 16 September 2014 is provided below.

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Addressing the Tax Challenges of the Digital Economy

This report sets out an analysis of the tax challenges for international taxation which the spread of the digital economy poses. It notes that because the digital economy is increasingly becoming the economy itself, it would not be feasible to ring-fence the digital economy from the rest of the economy for tax purposes. The report notes, however, that certain business models and key features of the digital economy may exacerbate BEPS risks. The report also analyses a number of broader tax challenges raised by the digital economy, and discusses potential options to address them including:

- Changes to the nexus and characterisation rules for income tax
- Proposal for withholding tax on the provision of digital goods and services
- Review the treatment of VAT/GST on business to consumer (B2C) transactions.

Neutralising the Effects of Hybrid Mismatch Arrangements

Currently, many countries have differing rules on the classification of entities and arrangements. For example in one country an entity may be treated as a company and in another it may be treated as a partnership, or in one country a financial arrangement may be classified as equity and in another country it may be classified as debt. This situation can lead to either double tax or double non-tax.

Part 1 of the report addresses the neutralisation in domestic tax laws of the effect of cross-border hybrid mismatch arrangements which produce multiple deductions for a single expense or a deduction in one jurisdiction with no corresponding taxation in the other jurisdiction. Part 2 of the report sets out proposed changes to the OECD Model Tax Convention that will ensure the benefits of tax treaties are only granted to hybrid entities (including dual resident entities) in appropriate cases.

Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

This report recognises that preferential regimes in OECD countries continue to be a key pressure area in international taxation, that these need to be dealt with more effectively and the work of the Forum on Harmful Tax Practices (FHTP) needs to be refocused with an emphasis on substance and transparency. This is an interim report that addresses:

- The use of preferential tax regimes in member countries should require substantial activity in that country
- Transparency and exchange of information between member countries on rulings on preferential tax regimes
- Engaging with non-member countries to participate in this initiative.

Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

This report includes proposed changes to the OECD Model Tax Convention to prevent treaty abuse on the basis that countries participating in the BEPS Project have agreed on a minimum standard to **prevent treaty shopping** and other strategies aimed at obtaining inappropriately the benefit of certain provisions of tax treaties. The report proposes specific anti-abuse rules including:

- Limitation on benefits articles to address treaty shopping situations based on the legal nature, ownership in and general activities of residents of a contracting state
- Changes to the tie breaker rules for dual residents
- An anti abuse rule for permanent establishments situated in third States.

Guidance on Transfer Pricing Aspects of Intangibles

This document contains revisions to the OECD Transfer Pricing Guidelines to align transfer pricing outcomes with value creation in the area of intangibles. The changes clarify the definition of intangibles and provide guidance for related parties; including transactions involving intangibles and the transfer pricing treatment of local market features and corporate synergies. The guidance looks at 'cash box' owners of intangibles with low functionality and mere contractual allocation of risk.

The allocation of returns from intangible will look beyond the legal ownership and contractual arrangements, to ensure the parties that contribute to the development, enhancement, maintenance, protection and exploitation of the intangible are appropriately remunerated.

Guidance on Transfer Pricing Documentation and Country-by-Country Reporting

This document contains revised standards for transfer pricing documentation and a template for country-by-country reporting of revenues, profits, taxes paid and certain measures of economic activity. These new reporting provisions, and the transparency they will encourage, are intended to contribute to the objective of understanding, controlling, and tackling BEPS behaviours. The reporting requirements will include identification and the use of the following criteria in each country:

- Revenues (related party and unrelated)
- Profit (loss) before income tax
- Income tax paid and accrued
- Stated capital and accumulated earnings
- Number of employees
- Tangible assets.

Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

This report identifies the issues arising from the development of a multilateral instrument that modifies bilateral tax treaties. It is noted that without a mechanism for swift implementation, changes to model tax conventions only widen the gap between the content of these models and the content of actual tax treaties. Drawing on the knowledge of experts in public international law and taxation, the Report concludes that a multilateral instrument is desirable and feasible, and that negotiations for such an instrument should be convened quickly.

Topics still to be addressed

The topics still to be addressed in respect of the BEPS Project are:

1. Interest deductions
2. CFC rules
3. Avoidance of PE status
4. Transfer pricing: risk and capital
5. Transfer pricing: high risk transactions
6. Methodologies and data analysis
7. Disclosure rules
8. Dispute resolution.

BDO Comment

The BEPS project represents an ambitious endeavour to inhibit international tax planning opportunities. The proposal to modify bilateral tax treaties by means of a single multilateral instrument is particularly novel in light of the negotiated outcomes that are generally reflected in such bilateral tax treaties. As Australia has committed to a 2017 time frame for introduction of the country by country reporting standard, it will require more urgent attention, particularly for taxpayers with cross-border related party dealings. We recommend you click [here](#) to view the BDO International webinar recording on the country by country reporting and if you have any queries on any of the above mentioned issues contact your BDO tax adviser.

National expertise

The BDO Tax team is one of the largest and most dynamic tax practices in Australia, with 27 partners and more than 150 specialists located in each major city across the country.

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