Current BEPS Action Items

BEPs – what is it?

The Base Erosion and Profit Shifting project (‘**BEPS**’) is bringing together over 100 countries to implement measures to tackle widely used tax planning strategies that are seen by governments as unacceptable shifting of profits to no or low tax locations. These ‘tax planning strategies’ include treaty shopping; tax-driven offshore and onshore financing and holding structures for real estate, fund and family office investments; avoiding local tax through structuring contracting procedures; locating valuable assets such as intangibles in no or low tax countries.

Why now?

The Multilateral Instrument (‘**MLI**’) was adopted on 24 November 2016 and signed by representatives of approximately 70 governments in June 2017. The objective of the MLI is to parachute into existing double tax treaties the treaty based BEPS measures, thereby giving them immediate effect. There is no ‘grandfathering’: all existing structures within scope will be impacted.

The first MLI driven modifications are expected to become operative in the course of 2018. Therefore, now is the time to review existing and proposed structures and arrangements and take all necessary action.

The 2017 update of the OECD model tax treaty, along with updated commentary, was released in July 2017. These will complete the process of affecting the treaty based BEPS changes.

Key BEPS issues

Access to treaty benefits

Access to tax treaty benefits for investment structures, including existing ones, is more difficult under a tax treaty modified by the MLI. Benefits will only be available if relevant new treaty tests are satisfied by a taxpayer: the principal purpose test (‘**PPT**’) and/or the limitation on benefits test. The relevant test for most of Europe is the PPT; treaty benefits (for example exemption from, or reduction of, withholding tax) will not be available if the obtaining of that benefit was one of the principal purposes of a structure or arrangement.

The OECD materials offer some guidance and examples. The theme emerging from these is that taking into account the existence of a favourable tax treaty when creating a structure is not harmful, as long as there are other non-tax drivers for choosing a location, such as legal and regulatory framework, skilled workforce, investor familiarity, substantive activities at an eg regional platform etc.

These tests will be applied to existing and new investment structures claiming a treaty benefit, eg a Gulf based family office holding European assets through a Dutch holding structure, or a fund investing through a Luxembourg platform.

Permanent establishment

Permanent establishment ('**PE**') is the threshold for the chargeability of a business to tax overseas. To avoid overseas PEs and tax exposure arising from overseas activities, businesses have long relied on what is termed the dependent agent exemption. Under this exemption, no overseas PE arose unless an agent was concluding contracts in an overseas jurisdiction for the home enterprise. The new threshold introduced by the MLI is an agent who, while overseas, '*habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification*'. This 'agent' could be a fund manager working on finding, negotiating or closing an overseas deal; or the client relationship manager of a bank visiting clients and developing overseas business.

Importantly, many European and other tax regimes do not distinguish between revenue and capital (trading and investing). Therefore, an overseas PE can arise even if overseas activities are related to investment (rather than trading).

Transfer Pricing

Mounting pressure for transparency is the relevant theme arising from transfer pricing BEPS measures.

Businesses will be required to provide detailed information, enabling tax authorities to conduct transfer pricing risk assessments and enquiries. The threshold for this sort-of country-by-country ('**CbC**') reporting and filing requirement is annual consolidated group revenue of €750m or more. The UK rules on CbC reporting also capture multinational groups whose ultimate parent entities are partnerships governed under laws in the UK, including LLPs.

Separately from CbC requirements, the format of required transfer pricing documentation is also changing. The filing of a 'local' and a 'master' file is now required for taxpayers with cross-border controlled transactions. The local file will look similar to current transfer pricing documentation, although some new and more detailed information is to be included. The master file will require an overview approach and detailed description of global operations. For example, the master file will require detail on group structure, mapping of group intangible property (including items such as customer lists and internally developed software), intercompany financial transactions, the group's financial and tax positions and certain tax rulings.

How can CMS help with action?

Tax is a key CMS service offered by our 400 tax and transfer pricing specialists across our jurisdictions. We deal with international tax issues against an increasingly complex legal background. CMS is ideally placed to assist your business with BEPS driven action items including:

Tax treaty access

— Review the substance of any entities in existing structures availing themselves of tax treaty benefits, to assess whether any additional substance is required for continued benefit from tax treaties. Reviewing existing financing arrangements will be part of this work, as many countries have now introduced rules along the BEPS interest relief restriction and hybrid mismatch recommendations.

— Consider, in light of the new guidance and examples given, if any previously employed structures can be recycled or sufficiently improved for new investments.

— Review alternative options when devising new investment structures. For example, consider whether reliance on domestic, rather than tax treaty based, exemptions is an option, or whether there are any structures available with government-blessed preferential tax treatment, such as securitisation vehicles or REITs.

— A cost benefit analysis will be mandatory in each case.

Permanent establishment

— Review existing operations and protocols and consider how those now require modification to avoid PE risks. Particular focus is required for guidelines regarding overseas negotiation and authorisation of contracts and decision-making protocols, and their implementation by operating staff.

— Review and map out existing overseas marketing, fund raising, deal sourcing etc activities and staff to identify new PE risks.

— If a new PE risk materialises, appropriate profit allocation to that new PE is required along updated transfer pricing principles, inter alia to avoid any potential double taxation.

Transfer pricing

— Identify, for disclosure purposes, intangibles and key value drivers. Review what could be classed as intangibles.

— Put systems in place that can track data in respect of revenue, pre-tax profit and taxes paid in each country in which they operate.

— Review the data collated and consider if there are any particular transfer pricing risks within the wider group.

— The first CbC reports in respect of years ending 31 December 2016 are due by 31 December 2017, and local requirements will vary from country to country.

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