Section Name

A Post-BEPS Primer for Boards: Staying in Control of Transfer Pricing Risks

The authors outline areas of inquiry for board members seeking to ensure that company tax officials are complying with new tax and transfer pricing rules implementing recommendations of the OECD's Action Plan on Base Erosion and Profit Shifting.

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With the OECD's recommendations under its Action Plan on Base Erosion and Profit Shifting mostly complete,[1] multinational companies already facing a multitude of compliance challenges must find ways to respond quickly to new tax rules being implemented around the globe. The transfer pricing items in the guidance—specifically, those covering intangibles and documentation—are likely to create some of the most significant additional compliance burdens. Given the scale of change foreseen, tax and transfer pricing compliance costs for multinationals are expected to increase by up to 50 percent.

In this environment, it is critical for companies' board members to start thinking about more efficient ways to stay in control of tax and transfer pricing risks. Looking forward, full standardization and automation of tax and transfer pricing processes must become an increasing area of focus on boardroom agendas.

Practical Implications

Eliminating double taxation, formerly a core mission for the OECD, now appears to have become a low priority for both the organization and for tax authorities—the OECD has no stated plans for addressing it in the next 10 years. The more pressing concern for many countries is eliminating ''double non-taxation,'' or income from a cross-border transaction that escapes taxation in either jurisdiction.

Generally, the OECD approaches agreed on in the BEPS guidance are expected to cause increased controversy as they involve high subjectivity and discretion in their application by tax authorities. As a result, there is a high probability that multinationals will witness an increase in their effective tax rates (ETRs) of between 10 percent and 20 percent.

In response, leading multinationals are taking a more forward-looking approach to their tax policies and dispute avoidance and resolution, starting to identify the activities that may become unacceptable post-BEPS. A regular review of tax policies with the board members is recommended so that companies can:

- gain a better understanding of the various existing intercompany financial and non-financial structures that need to be eliminated or changed;
- assess the mismatch between ETR shown on the income statement and average expected tax rate based on where sales are made to assess the potential for any reputational damages;
- appropriately plan the management of tax and transfer pricing processes to prevent higher compliance costs in the long run; and
- drive meaningful, facts-based communication and disclosure of tax and transfer pricing practices among both internal and external stakeholders.

Thus companies' tax agendas post-BEPS must stay high on the priority list for boardrooms. The following

[1] 24 Transfer Pricing Report 732, 10/15/15. Reports available from the Organization for Economic Cooperation and Development at http://www.oecd.org/tax/beps-2015-final-reports.htm.

section examines the key focus areas that will need to be addressed during these meetings.

A Post-BEPS Tax Agenda

The following 10 questions regarding the company's tax agenda are suggested as a way to structure a dialogue between board members and tax and transfer pricing executives.

1. As a result of the OECD's BEPS recommendations, is there a risk that the company's name will be on the front page of any newspaper on tax matters? If so, please quantify the probability and what in-house tax personnel are doing to mitigate that risk.

2. Is compensation to all group companies aligned with their contribution to the firm's value chain?

3. In light of the country-by-country reporting requirements that many countries already have adopted, which will require disclosing information about the company's value chain to all tax inspectors involved, is the company willing to share its tax positions with all relevant stakeholders without reservations?

4. How can the company control its compliance costs, which more than likely have doubled due to the time and effort spent on responding to new measures on BEPS?

5. What is the cost of running the tax function—in-house as well as external—and how does that compare to what's known about the company's peers regarding tax planning for the next two years?

6. Does the company still use hybrid structures, extreme debt positions or other tax-driven structures that are the target of the BEPS guidance? Is there any corporate tax position below an effective tax rate of 15 percent?

7. Did the in-house tax group revise the company's organizational and operational setup to comply with the BEPS guidance? If so, please list the top three major initiatives undertaken or achieved.

8. How does the company keep tax authorities at a distance while not turning the in-house tax function into one big tax or transfer pricing compliance exercise under BEPS?

9. What is the percentage of the in-house tax team's total time spent on communication with internal and external stakeholders on post-BEPS risk management measures?

10. Which top 10 countries are most vulnerable from a tax and transfer pricing perspective and how does the company set priorities in these countries?

Conclusion

As governments around the world draft and adopt measures to implement the OECD's recommendations for combating BEPS, companies must be ready to respond quickly to a radically altered tax landscape. Boardrooms must take a conscious stance on transfer pricing matters by encouraging structured and frequent reviews of sensitive topics raised by the OECD project.

Key BEPS Focus Areas

BEPS focus area	Explanation
Country-by-country reporting and transfer pricing documentation	Detailed templates and indexes of transfer pricing documentation that need to be filed in each country have been agreed. This includes a country-by-country reporting template, which requires multinationals to annually disclose information relating to the global allocation of income and taxes paid.
Transfer pricing	Additional recommendations created by the OECD would disallow attribution of significant profits to group entities within a multinational claiming to perform activities (for example, management of intellectual property), unless it is proved to have the people and capacity to do so.
Hybrid instruments and entities	Additional OECD recommendations would overcome tax avoidance triggered by differences in classification of entities or instruments in different countries. For example, an entity might be considered a company in one country and a partnership in another, or an instrument might be treated as debt by one country and equity by another.
Denial of interest deductions	Additional recommendations would have countries establish a fixed cap for deduction of interest, within a range of 10 percent to 30 percent of either earnings before interest and tax (EBIT) or earnings before interest, taxes, depreciation and amortization (EBITDA).
Tax incentives or preferences	Where preferential tax regimes (for example, patent or innovation boxes) apply, OECD recommendations call for strengthening the requirement to show substantial economic activity in the country, and a nexus between expenditure on that activity and the income benefiting from the preferential tax regime.
Taxable presence	Revisions are proposed to the definition of the taxable presence (that is, the tax treaty definition of a permanent establishment) that will make it more difficult for a company to avoid attributing profits from sales in a country if it has an affiliate or agent there that concludes the contracts.
Mandatory disclosure schemes	Countries are encouraged to introduce requirements for disclosure of aggressive or abusive transactions, arrangements or structures, either by their promoters or users or both, with recommendations for rules targeting international schemes.