The BEPS Project

By Steve Suarez, Borden Ladner Gervais LLP

International tax issues are receiving quite a bit of news coverage these days, ranging from stories about multinational corporations arranging their affairs to pay less tax (relative to sales or revenues) in particular countries in which they operate, to U.S. companies pursuing inversions to shed their U.S. tax residence and thereby reduce their U.S. taxes. Governments in search of tax revenues are increasingly concerned with the alleged exploitation of gaps and mismatches in the tax rules of different countries. Fairness concerns are created when multinational groups are able to use such planning to reduce their overall taxes in ways that taxpayers operating only in one country cannot.

As noted in last edition's column, Canada introduced a proposal in the 2014 federal budget to greatly restrict the ability of non-residents to claim the benefits of Canada's tax treaties, unilaterally changing the terms of these agreements Canada has with over 90 other countries. More broadly (and, happily, more collaboratively), tax authorities in different countries are working together to study various ways in which international tax rules should be updated to address the challenges of a modern globalized economy. Many of the fundamental elements of the international tax system are largely unchanged over the past 50-75 years, and over that time cross-border commercial activities have both grown and changed dramatically.

The Organization for Economic Cooperation and Development (OECD) is serving as the focal point for this initiative. Referred to as the base erosion and profit shifting (BEPS) action plan, this project arose from a joint declaration of various OECD member and non-member countries to the effect that multilateral action was required on tax compliance and avoidance concerns that "constitute[e] a serious risk to tax revenues, tax sovereignty and the trust in the integrity of tax systems of all countries."

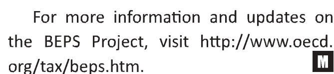
The OECD's Fiscal Affairs Committee has struck a number of working parties to examine and develop recommendations on various areas, including:

- Preventing the abuse of tax treaties: agreements between two countries to reduce or eliminate one country's taxation of income earned in that country by residents of the other country;
- Dealing with the effect of hybrids: for example, securities treated as debt in one country's tax system and equity in another country's;
- Responding to tax challenges created by the digital economy and the increasing importance and value of intangible assets;
- Determining what degree of business activity in one country by a resident of the other country constitutes the right threshold for allowing the first country to tax the resulting business income; and
- Creating appropriate rules for transfer pricing, applicable to transactions between non-arm's-length entities in different countries, which can significantly shift income or deductions from one country to another.

These are hugely important issues for today's globalized economy, and getting these issues right is critical to ensuring that cross-border commerce and investment is not strangled by overboard and unworkable tax rules that do not give businesses and investors a meaningful degree of certainty as to the tax results. This is particularly crucial in capital-intensive industries such as the mining sector where large up-front investments are required and the payback period stretches over many years. Unless mining companies and their investors have confidence in what the results will be, they will not undertake new projects.

The OECD has adopted an extremely aggressive timetable for generating and acting on these work streams, with three reports and four draft recommendations scheduled to be presented to the Committee on Fiscal Affairs at the end of June 2014. Other deliverables are due in September 2014 and September 2015.

It will be extremely interesting to see what these initiatives produce, and what degree of acceptance they are met with. Different countries often have different views as to what constitutes abusive tax planning or what the appropriate nexus is for taxing the activities of non-residents, as is already becoming apparent from statements by tax authorities in various countries. While multilateral discussion is certainly the preferred approach over Canada's unilateral proposals, it remains unclear to what degree a consensus will develop. In the meantime, the mining sector needs to make sure its concerns are heard by those developing sweeping new international tax rules that will affect all of us.



For more information and updates on the BEPS Project, visit http://www.oecd.org/tax/beps.htm. M

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