

# **European Business Initiative on Taxation (EBIT)**

**Comments on the OECD's Base Erosion and Profit Shifting initiative**

At the time of writing this submission, EBIT Members included: AIRBUS, BP, CATERPILLAR, EADS, DEUTSCHE LUFTHANSA, INFORMA, MTU, NUTRECO, REED ELSEVIER, ROLLS-ROYCE, SAMSUNG ELECTRONICS, SCHRODERS and TUPPERWARE.

## **EBIT Comments on the OECD's BEPS report and outcome of the BIAC discussion day on BEPS**

Will Morris  
Chair, BIAC Tax Committee  
Business and Industry Advisory Committee to the OECD  
13/15 Chaussée de la Muette  
75016 Paris  
France

Brussels, 5 April 2013

Dear Will,

The European Business Initiative on Taxation (EBIT)<sup>1</sup> first of all wishes to thank BIAC for the opportunity to provide written comments on the OECD's Base Erosion and Profit Shifting (BEPS) report and on the outcome of the BIAC discussion day on BEPS held on 26 March 2013.

This letter sets out the general and more specific comments and concerns of EBIT about the OECD's BEPS initiative.

Since its establishment in 2001, EBIT's aim has been to help eliminate remaining tax barriers in Europe and encourage the implementation of business-friendly solutions. EBIT considers this to be a very important topic for the business community. EBIT's input to OECD and EU tax policy-makers and other key stakeholders such as BIAC is always rooted in the day-to-day practice and experience of EBIT's member companies.

### **KEY MESSAGES**

- EBIT acknowledges that with the OECD's BEPS initiative in response to the G20 Leaders' request, and, inter alia, the EU's December 2012 package, there is a new international political reality that cannot and must not be ignored, and that as a result, the international tax landscape is already changing. However, it is important that any changes are designed to last and are capable of practical application. EBIT also wishes to emphasise the importance of stability and certainty in creating an environment for long-term and sustainable investment.
- EBIT welcomes the debate on BEPS and acknowledges with the OECD in its BEPS report to the G20 that there are some areas where the current tax legislative framework simply has not kept pace and therefore does not sit easily with some of today's business models.
- EBIT is convinced that modernising and streamlining the international direct tax policy framework further should help to create an environment in which businesses can comply more easily with tax regulations and enable them to concentrate on competitiveness, sustainable growth, investing in people, R&D and innovation.
- In today's policy-making context of fiscal consolidation, growth and fairness, EBIT wishes to reiterate its commitment to proper tax compliance and transparency and openness. EBIT believes companies, whether big or small, should meet all local and cross-border requirements for proper tax compliance. EBIT supports, in general and

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<sup>1</sup> At the time of writing this submission, EBIT Members included: AIRBUS, BP, CATERPILLAR, EADS, DEUTSCHE LUFTHANSA, INFORMA GROUP, MTU, NUTRECO, REED ELSEVIER, ROLLS-ROYCE, SAMSUNG ELECTRONICS, SCHRODERS and TUPPERWARE spanning the following business sectors: aerospace and defence, aircraft engine manufacturers, airlines, conference organisers, earth moving equipment, electronics, financial services, food, food containers, healthcare equipment, oil, pharmaceuticals, publishing, retail, software, and train manufacture.

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in principle, fiscal transparency although this needs to be balanced with the fundamental right to privacy which companies enjoy under EU and international human rights law, and with particular emphasis on commercially sensitive information. It also needs to avoid creating a disproportionate incremental compliance burden and should ensure a level playing field so that MNEs located in the EU and/or OECD jurisdictions are not competitively disadvantaged. At the same time, we believe that relationships between tax authorities and tax payers should be based on mutual trust, mutual understanding and mutual transparency (i.e. appropriate levels of disclosure).

- EBIT believes that today's political reality reflects not only national politicians' difficult balancing act between trying to attract additional national revenue in the short term and at the same time protecting their fiscal sovereignty in the context of increased globalisation, but also, and importantly, a growing degree of unease and even moral indignation among many ordinary, hard-working people about those multinational groups (MNEs) who are perceived to not be paying their fair share of tax. This generally negative and simplified image of MNE groups is carefully cultivated by certain media and certain ideological NGOs, yet the debate often remains ill-informed and one-sided. In particular, the almost exclusive focus on corporation tax overlooks the importance of MNEs as drivers of growth and investment and the contributions MNEs make via VAT/sales taxes, payroll and other taxes. Moreover, EBIT believes that all parties (tax administrations, taxpayers and NGOs) must work responsibly together to counter the growing sense of anti-business sentiment.
- EBIT wishes to reiterate that it is against tax fraud and tax evasion. EBIT believes that businesses who commit tax fraud should be prosecuted and fully supports the introduction of measures designed to counter tax fraud and tax evasion. Also, not all taxpayers are the same. For example, taxpayers should be differentiated based on their risk profile – high risk taxpayers being the subject of closer scrutiny than others. We think there needs to be a “carrot” as well as a “stick” to encourage “good” taxpayer behaviour.
- At the same time, EBIT wishes to stress that tax planning and “aggressive tax planning”, is not the same as tax fraud and tax evasion. According to EBIT, the BEPS debate needs to focus on the presence of artificiality and/or the absence of substance in certain tax planning schemes. In EBIT's view, the following points should also be borne in mind in any discussion on “aggressive tax planning”:
  - Taxpayers have an obligation to all stakeholders, shareholders and tax administrations, to comply with tax laws in a responsible manner;
  - As such it is for governments to set the tax legal and regulatory framework and for taxpayers to comply;
  - It is perfectly legitimate and reasonable for companies to consider tax alongside a number of other commercial considerations when deciding on investment decisions or process innovation and they are actively encouraged to do so through fair tax competition between countries. Indeed, where governments offer incentives to taxpayers through legitimate tax competition, they should expect taxpayers to take advantage of them;
  - Taxpayers should be respectful of the intention of the legislators when structuring their tax arrangements (this includes our point about substance);
  - There will be circumstances in which governments and taxpayers can legitimately disagree.

As a result, EBIT believes therefore that fiscal sovereignty remains key in the BEPS debate and without it many countries and businesses will no longer be able to adequately compete internationally.

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- Although EBIT understands the political drive for early action on these matters, it is important that actions taken address actual problems rather than perceived problems. Ideally, the first item in any BEPS “action plan” should be to collect more accurate and definitive data on the scale of base erosion, and identify to the best extent possible which countries are suffering from base erosion to the greatest degree. If collection of additional data indicated, for example, that base erosion is primarily restricted to developed nations with weak exit taxes, it would follow that the remedies are stronger exit tax, and/or CFC rules where exit taxes may be difficult to calculate. EBIT is concerned that, instead, precipitate action will be taken on a perceived problem that “consumer” countries are paying “excessive” royalties or interest, when in truth the royalties/interest are reasonable. “Remedies” of “consumer” countries disallowing deductions, rather than combatting base erosion, actually lead to these countries engaging in base enhancement – appropriating for themselves an increased share of the tax take, and increasing the risk of double taxation.
- EBIT considers that in this political context, and in our day to day practice, we are witnessing more and more “aggressive tax collection” on the part of tax administrations. However, the BEPS debate should not be a “one way” street. We think that a key aspect of the debate is the efficiency/effectiveness of tax administrations and the beneficial impact this can have on business should not be overlooked.
- The global environment is changing more rapidly than at any point in history. Any new “rules” that are introduced need to be sufficiently flexible to avoid a need for constant rewrites. This might lead to a more “principle” rather than “rule” based approach.
- There must be a global solution to address these issues.
- So, whilst EBIT understands the concerns of hard-working people and tax administrations and the urgency to tackle the issue of BEPS, at the same time, EBIT has a number of more specific comments and serious concerns with regard to the BEPS approach now followed by the OECD, which are set out below.

### **MORE SPECIFIC COMMENTS AND CONCERNS ABOUT BEPS**

- Some of the issues in the OECD's BEPS report to the G20, for example the first example in Annex C, are country-specific, reflecting a failure of the residence state's CFC regime to properly reflect the criteria used by certain other countries to determine taxability of locally incorporated companies. This can only sensibly be addressed by the relevant residence state amending its CFC rules to limit the relevant exception to where the locally incorporated company is actually in charge to local corporation tax. EBIT recognises that some instances of double non-taxation arise from the interaction of domestic law and international tax conventions, and could be addressed through greater consistency and coordination of domestic CFC rules. EBIT would welcome international cooperation to better coordinate CFC rules, provided that all stakeholders, including business and countries who are not full members of the OECD were fully consulted.
- EBIT is concerned that only India was represented at the BIAC meeting of 26 March 2013 and that only Russia is we understand a member of any of the three BEPS work streams. The BEPS initiative will have achieved little other than disadvantaging OECD member multinationals if the BRICS and indeed all the big emerging economies (E-7) are not fully bought into the BEPS recommendations from the start.

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- The BEPS report highlights concerns that the existing Transfer Pricing Guidelines place too much emphasis on legal structures (such as contractual risk allocations) rather than underlying economic reality. However EBIT believes that the work performed by the OECD on Business Restructuring and the latest Discussion Draft on Intangibles have introduced clear guidance on the concept of 'control over risk' without the need to migrate away from the Arm's Length Principle. EBIT therefore considers that existing work should be progressed based on existing Arm's Length Principles rather than redefining existing Transfer Pricing Guidelines in favour of simple formulary apportionment or profit split methods.
- EBIT understands that two principal concerns as regards the BEPS Transfer Pricing work stream are:
  - Supply chains where the pricing is arm's length in all non-principal enterprises but there is arguably insufficient substance in a low tax principal; and
  - Situations where risk is backed by significant capital in a low tax jurisdiction but again there are concerns around the substance in the low tax location.

EBIT's response to these scenarios is that existing principles of Transfer Pricing as outlined in the Discussion Draft on Intangibles should be applied, namely that the comparability analysis should appropriately reflect all relevant factors materially contributing to the creation of value where substance issues would be addressed as a result.

- EBIT recognises the public and political concerns expressed about double non-taxation of income, and very low effective tax rates reported for some MNEs, particularly in the digital economy, but does not accept that these concerns should be addressed through a significant change in the interpretation of Articles 5 and 7 of the OECD Model Treaty. EBIT believes that the specific issues that arise from the digital economy and new retailing models should be addressed through a Technical Advisory Group (TAG) that should work closely with the Working Party 9 and the existing TAG on International VAT/GST Guidelines. EBIT therefore considers that, especially as regards the BEPS "Jurisdiction to Tax" work stream, a more holistic approach should be adopted, taking into account in particular the new EU-wide place of supply VAT changes which will apply from 1 January 2015 for telecoms, e-services and broadcasting.
- EBIT does not consider that anecdotally reported instances of double non-taxation involving corporate structures that include branches or PEs create a need to substantially review or revise the existing Commentary on the interpretation of Articles 5 and 7 of the OECD model treaty. Double non-taxation in this context appears to be a result of the domestic law and practice of the country of residence of the enterprise and not a result of imperfect definition or interpretation of the existence of, or profits attributable to a PE. However, EBIT accepts the need to ensure that there is a consensus on the interpretation of both articles and that, if specific areas of concern are identified, that some adjustment to the detail of the Commentary may be required, but should be subject to the OECD normal practice of seeking consensus and consulting with business. EBIT in addition notes the deemed services PE now at paragraph 42.23 of the OECD Model Commentary on Article 5 that illustrates the sort of provision that could be considered in addressing the jurisdictional issue.
- EBIT notes the comments on page 50 of the BEPS report regarding "well known existing legal constraints" such as the need to have regard to the existing 3,000+ bi-lateral tax treaties. EBIT notes that 19 of the current 34 OECD members are also signatories of the Vienna Convention on the Law of Treaties. Article 27 of that

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Convention prevents the Convention signatories from “invoke(ing) the provisions of internal law as justification for its failure to perform a treaty”. In addition, most of the 3,000+ double tax treaties are not between the 34 OECD members. Accordingly, reliance cannot for those treaties be placed on Article 31(3)(a) of the Convention i.e. “any subsequent agreement between the parties regarding the interpretation of the treaty(ies)” via e.g. the OECD Model Commentary.

- Overall the BEPS report notes the increase in contributions made by corporation tax over the last 25 to 50 years despite declining statutory tax rates and the role that business plays in sustainable growth and innovation. The reason that governments engage in generally limited forms of corporate tax competition is to encourage investment into key areas of benefit to the overall economy. EBIT therefore would welcome additional research into evidence for the overall effects of corporate tax competition on the different forms of overall tax contribution made by companies taking into account wider economic policy objectives.
- Whilst EBIT is composed of MNE groups operating in the EU, we believe that the BEPS debate should not focus exclusively on MNEs but also take full account of the situation of SMEs who, in Europe, are increasingly faced with aggressive taxation by member state governments.

EBIT trusts that the above comments are helpful for BIAC and will be taken into account in the OECD's decision-making on BEPS going forward.

Yours sincerely,

**The European Business Initiative on Taxation – April 2013**

For further information on EBIT, please contact its Secretariat via Bob van der Made, Tel: + 31 (0) 6 130 96 296; Email: [bob.van.der.made@nl.pwc.com](mailto:bob.van.der.made@nl.pwc.com)).

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