KPMG

Base Erosion and Profit Shifting (BEPS)

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What is BEPS?

Base erosion and profit shifting (BEPS) refers to tax planning strategies that allow multinationals to take advantage of gaps and mismatches in international tax laws to reduce or shift profits from high tax jurisdictions to low tax jurisdictions and decrease their overall tax burden.

The BEPS Project is a global initiative launched by the Organisation for Economic Co-operation and Development (OECD) to modernise the international taxation system in line with economic substance and value creation. On 5 October 2015, the OECD issued its final recommendations for tackling BEPS through 15 key areas (the “BEPS Package”). As at January 2017, there were 94 jurisdictions that have formally committed to the BEPS Package, including China (PRC) and Hong Kong. The BEPS project has raised the bar for international tax policy and administration across the world.

What does BEPS cover?

The BEPS Package is focused on transparency and substance, and includes recommended changes to international tax laws with respect to the areas listed on the right:

- Introduce Country-by-Country (CbC), master file and local file reporting requirements for transfer pricing
- Ensure that tax outcomes for related party arrangements align with value creation under transfer pricing (TP) principles
- Neutralise mismatches arising from the use of hybrid arrangements (e.g. by denying interest deductions)
- Introduce compulsory information exchange and substance requirements relating to the use of preferential tax regimes
- Prevent tax treaty abuse (e.g. by denying treaty benefits in inappropriate circumstances)
- Prevent artificial avoidance of permanent establishment (PE) status (i.e. taxable presence)

Who is impacted by BEPS?

China has adopted several of the BEPS recommendations and has already rolled out the BEPS transfer pricing (TP) documentation requirements. China companies in multinational enterprise (MNE) groups which meet certain thresholds will need to prepare master and local files and a special documentation file, with 2016 files to be ready by mid-2017. In many cases, these files are much more detailed than the BEPS requirements. Supplemented by enhanced related party reporting requirements and the CbC reporting, for which exchanges enter into effect from 2018, the new data may drive an upsurge in the level of China tax authority scrutiny and challenges.

China has also indicated an interest in adopting the BEPS proposals on PE, controlled foreign company (CFC) rules, hybrid mismatch arrangements and treaty abuse, and is looking to localise the BEPS-updated TP guidance for the Chinese economic environment. Existing MNE tax planning conducted cross-border into China will be impacted, necessitating the review of existing business models, and new designs for future tax structuring arrangements. The speed of change will become more apparent later in 2017, when China determines the extent of its participation in the global multilateral instrument for simultaneous update of most of the world’s tax treaties.

How will BEPS impact multinational groups operating in China?

MNEs operating in China and China MNEs investing overseas should review their existing operations, legal structures and TP practices to ascertain how risk areas and opportunities arising from BEPS-related developments can be managed to minimise business disruptions, particularly with regard to:

- The MNEs' China distribution structures using offshore sales hubs and onshore marketing support subsidiaries may become prone to both PE and TP challenges. In some cases, restructuring into an onshore distributor may be necessary.
- Outbound royalty and service fees from China have been and will continue to be under severe scrutiny. This particularly applies to payments made to low function offshore group entities in low tax jurisdictions. Upgraded TP documentation will highlight the concentration of profits in offshore services/intellectual property (IP) holding companies, and charges will need to be increasingly justified with transactional level TP support.
- MNE structures involving China manufacturing, R&D and sales support functions housed within separate entities, and each being remunerated on a cost-plus basis, will face particular scrutiny on a TP and PE basis.
- M&A/restructuring transactions will also be under enhanced scrutiny with new TP documentation requirements. Planning in relation to restructuring relief, indirect offshore disposal rules, and treaty relief all need to be conducted with the utmost care. Having proper valuation will be crucial to avoid TP challenges.

How can KPMG help?

KPMG can help you gain a full understanding of how BEPS might impact your business and develop an approach for addressing any areas of concern. We can also help realise potential opportunities in the evolving tax landscape created by BEPS.

Identify potential areas of concern and opportunities for improvement based on:

- Legal entity structure
- Supply chain/operating model
- Intangible property ownership and exploitation
- Transfer pricing policies and documentation
- Key legal entity tax attributes and current tax positions (particularly those relying on a tax treaty)
- Intercompany and third-party financing structures

Quantify an estimate of the potential impact for your business from a cash tax and effective tax rate perspective

Analyse and prioritise our findings across various metrics including:

- Quantitative
- Qualitative
- Compliance
- Disclosure
- Timing risks
- Local BEPS developments in each of the jurisdictions in which you operate

Develop an approach to rectify areas of concern and make improvements, taking into account:

- Business objectives
- Reputational considerations
- Financial efficiencies

Prepare for relevant communications with key stakeholders (e.g. board members, investors and the media)

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