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OECD BEPS Action Plan

Ready or not?

Global survey of tax executives

January 2015

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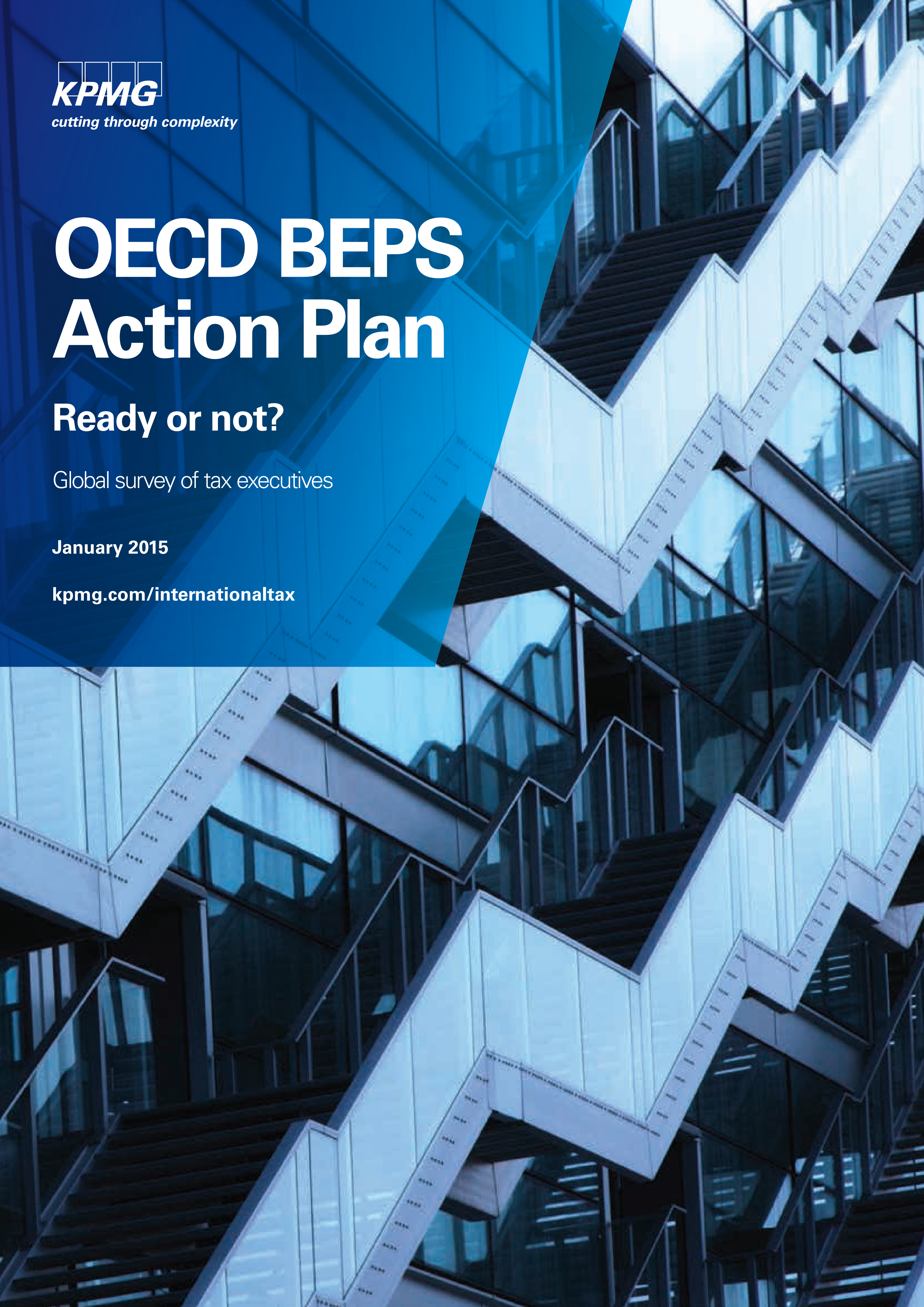


Introduction

For today's tax executives, the future of international taxation has never been more uncertain. The global project to address tax base erosion and profit shifting (BEPS) is in full swing, and the Organisation for Economic Co-operation and Development's (OECD) Action Plan on BEPS is progressing quickly. By December 2015, the OECD is expected to produce guidance on all 15 of the Plan's action points to modernize tax rules and prevent international companies from paying little or no tax.

Most OECD and G20 countries are engaged in the OECD's work, and many other countries are either fully engaged or watching developments closely. Many countries will make – or are already making – domestic international tax reforms as a result. What the OECD will ultimately recommend and how individual countries will translate these recommendations into law are unknown. At the same time, countries are proceeding to impose rules and negotiating agreements to thwart tax abuses and promote more tax transparency over the tax affairs of global companies.

How are tax executives around the world managing the impact of these developments and preparing for uncertain times ahead? KPMG International polled senior tax executives from global companies around the world to find out their views in three broad areas:

1. **Awareness and impact –** What is the level of awareness of the implications of the OECD Action Plan among companies at the tax function, upper management and board levels? Is the OECD's work and the broader tax transparency debate changing the way companies govern their tax affairs and manage their tax risk?
2. **Concern –** What aspects of the OECD BEPS Action Plan worry tax executives most? Do they believe the OECD's work will ultimately result in improvements to the taxation of cross-border transactions, or will their companies continue to weather inconsistency and uncertainty?
3. **Action –** What steps are companies taking to address BEPS risks and position their tax functions for success in the years to come?

To deepen our understanding of how tax executives answered these questions, we drew on the knowledge and experience of senior tax leaders from KPMG International and KPMG's network of member firms.

These findings and analysis indicate that many forward-thinking tax executives are concerned about the impact of the OECD BEPS Action Plan and are actively engaged in the process to understand and anticipate potential changes.

[1] Organisation for Economic Co-operation and Development (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing. *http://dx.doi.org/10.1787/9789264202719-en* (referred to herein as "OECD Action Plan").

Contents

Key findings

How are tax executives of global companies responding to international tax policy developments arising from the OECD's BEPS Action Plan? KPMG International's survey of tax executives revealed the following key findings. These results and their implications are analyzed in detail in the following pages.

Awareness and impact

- **One in four** tax executives say their company's tax profile has been the subject of tax-related media reports in the past 12 months.
- **Over one in five** companies reviewed public tax data about their company and found information that could be of concern.
- Potentially troubling tax data was found by **55%** of food, retail and consumer goods companies, **50%** of real estate companies, and **43%** of energy and natural resources companies that conducted a review.
- **29%** of tax executives surveyed say their company has both a written tax code of conduct and a formal tax risk management policy.
- **Almost one-quarter** of tax directors say their company directors and senior executives have a high level of understanding about the implications of the tax transparency debate and are engaged and interested in potential actions they should consider.

Concern

- Aspects of the OECD BEPS Action Plan that concern tax executives most are:
  1. transfer pricing rule changes
  2. tax information disclosure requirements
  3. changes to international tax rules
- **28%** of respondents say the OECD's transfer pricing documentation proposal would create concerns about their tax profile.
- **36%** of respondents believe that the Action Plan may lead to changes in the manner in which they currently hold intellectual property.
- **Only 30%** of tax executives believe the Action Plan sets the right balance for protecting the interest of governments and preventing base erosion and profit-shifting.
- **Half** of companies believe inadequate time has been allocated to accomplish the goals of the Action Plan.
- **44%** of companies believe the OECD's proposals on the digital economy will increase their total tax burden and reporting obligations.

Action

- **11%** of respondents say that their primary action step is to wait before the law changes before taking any action.
- In responding to the BEPS Action plan, tax executives say the most significant proactive steps are:
  1. determining that documentation and compliance is adequate
  2. reviewing tax planning and operations
  3. increasing efforts to take part in shaping BEPS-related tax policy
- **35% of tax directors** have access to a benchmarking analysis to help assess the activities of other companies in their peer group/industry.
- **26%** have access to a comprehensive resource to monitor BEPS-related developments, including country updates on proposed and enacted tax law changes.
- **18%** have access to a forum for sharing leading practices and collaborating on tax policy development.

About the survey

- KPMG International's global benchmarking survey of senior tax executives aims to gain insights on how global companies are responding to BEPS-related international tax policy developments.
- We asked 235 senior tax and finance executives in 23 countries to take part in an online survey and share their opinions on the issues and challenges arising from the OECD BEPS Action Plan.
- To shed more light on implications of the survey's findings for international companies, we interviewed senior KPMG tax leaders with KPMG International and its network of member firms.

OECD's BEPS project – the best-laid plans…

With new technologies and globalization of the world economy, international enterprises have moved from country-specific to global models with integrated supply chains, centralized service functions, and ever more capacity to market and/or deliver services and products via the digital domain. Increasingly, governments, the public and others – including the OECD – perceive that these developments have opened opportunities for international companies to greatly reduce their tax burden. This perception has heightened sensitivity over how much tax companies are paying in the countries in which they earn profits.

To remedy this situation, the OECD undertook the task of developing consensus on a coordinated implementation of uniform international taxation principles for the modern age. The OECD's Action Plan on Base Erosion and Profit Shifting (BEPS), issued in July 2013, sets out 15 specific actions that will give governments the domestic and international instruments to prevent corporations from paying little or no taxes.

The OECD Action Plan items are targeted to be complete by December 2015 – an extremely tight timeframe. Has the OECD allowed enough time to accomplish the Action Plan's goals? Tax directors are skeptical. In response to KPMG International's global survey, about half of the respondents say the allotted time is not enough.

The OECD's working groups have held to the OECD Action Plan timetable so far, and it seems likely that they will continue to deliver according to plan. Nevertheless, tax executives' skepticism is understandable. The need to gain consensus on aligned taxation approaches among so many countries means that executing the plan within 24 months is a challenge. Because the plan is so complex and large in scope, there is a risk that the outcomes will lack integration, depth and detail. The accelerated timetable may not leave enough time for broad consultation among policy makers, tax authorities and businesses. All of these factors create the risk of double taxation or other unexpected results as countries transpose the guidelines into their own domestic laws.

Further, the OECD BEPS Action Plan is only a first step. After it is complete, it will be up to individual countries to translate their interpretation of the OECD's principles into law. If all goes according to plan, the OECD's work will produce a set of broad principles that are interpreted and implemented uniformly, and tax executives will enjoy a simpler, fairer and more consistent international tax system as a result.

But if the work is rushed, the lack of detailed guidance and buy-in among countries could result in a patchwork of different taxation principles and provide more occasion for tax disputes. For now, both scenarios remain possible, and some combination of the two will most likely result.

In the next section, we examine how deeply the implications of the OECD BEPS Action Plan are understood within international companies among tax executives, senior management and boards.

49% of tax executives say the OECD has not allotted enough time to complete its BEPS Action Plan.

Tax transparency – all clear?

The OECD BEPS Action Plan is accelerating the trend toward greater tax and financial transparency that started after the accounting scandals of the early 2000s and gained momentum following the 2008 financial crisis. Several Action Plan items aim to increase the amount of tax-related information that international companies are required to disclose. As this data comes to light, many companies could face more scrutiny and questions about their tax planning practices.

When the OECD embarked on the BEPS Action Plan in early 2013, public anger over perceived international tax avoidance was at its peak. In the years following the 2008 financial crisis, populations in Europe and North America were feeling the pinch of constrained government finances. Stoked by media reports and government inquiries, new social attitudes sharpened the focus on civic responsibility and expectations that corporations should pay their fair share of tax to the jurisdictions in which they earn profits.

In this environment, international companies began to confront reputational risks associated with tax planning that they had never before encountered. Media reports on the amount of tax individual companies were paying drew negative attention from investors and consumers. Early reports tended to target private, US-headquartered companies. More recently, attention has spread to include companies based in, among others, the UK, the Netherlands and Australia.

About one-quarter of tax executives surveyed say their company's tax profile has been the subject of media reports in the past 12 months. By industry, the top three subjects of tax-related media reports globally were companies in the communications, mining, and energy and natural resources industries.

More recently, as understanding of the role of tax competition and appreciation of the complexity of the issues involved has increased, there are fewer examples of misleading or incomplete reports. There are more examples from non-governmental organizations (NGO) and in the media of balanced political arguments that recognize how tax planning and tax competition contribute to business and economic growth. The work of the OECD and individual governments is offering assurance that something is being done to address BEPS-related problems.

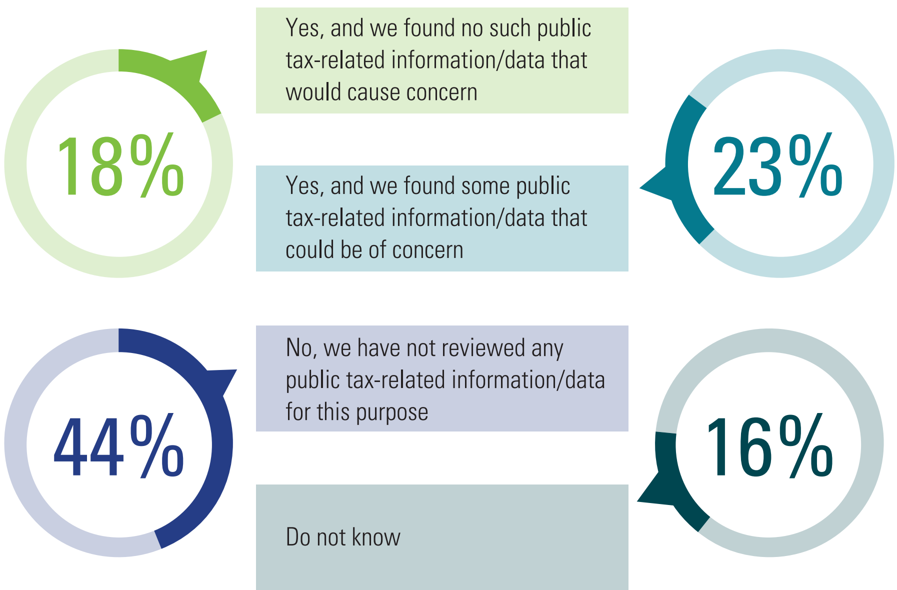
Nevertheless, where companies' tax plans involve low-tax jurisdictions and offshore structures, the details of these arrangements can still be over-simplified and reported inaccurately. In light of this risk, many tax directors surveyed say their company has reviewed public tax-related data to determine whether the tax authorities or the media could perceive or portray that information in a negative light.

***26%** of tax executives say their company's tax profile has been the subject of media reports in the past 12 months*

Over 1/2 of companies that reviewed public tax data about their company found information that could be of concern.

55% of companies in the food, drink and consumer goods industries that conducted a review found potentially troubling tax data.

Has your company conducted an in-depth review of public tax-related information/data to identify and evaluate whether your company's tax profile could be portrayed or perceived negatively by either tax administrations or the public/media?



Source: KPMG International, 2015

Tax ethics and risk – documenting your approach

To help communicate your company's tax position, a written tax code of conduct and a formal tax risk management policy can be valuable:

- A company-wide **tax code of conduct** generally seeks to clarify the line between what the organization considers acceptable and unacceptable from a tax planning perspective – internally and externally.
- A **formal tax risk management policy** generally seeks to set out a detailed tax governance framework that helps the company reduce its effective tax rate responsibly while managing its tax risk.

The primary purpose of both documents is generally to set clear, commonly understood guidance on which parties are responsible for making decisions about tax, within the tax function and in other functions, such as procurement, finance and HR. These documents can help demonstrate to investors, tax authorities and the media that your company is managing its tax obligations effectively and responsibly.

Fewer than one in three tax executives surveyed say their company has both a written tax code of conduct and a formal tax risk management policy in place, but most companies have adopted or plan to adopt a code, policy or both. This suggests many companies may be still catching up with the need to set clear ethical guidelines and to document their tax risk management practices.

Respondents in Europe, the United States and Australia are more likely to report having both tax governance tools than the global average. This result reflects the rising priority in these regions on tax governance over the past several years. High public volatility over tax matters in these regions has made company directors and senior management in these regions more attuned to tax and reputational risk. Tax is also gaining attention beyond the tax function as boards and C-level executives in countries like the United Kingdom and the Netherlands contend with rules requiring senior accounting officers to certify the effectiveness of internal tax controls and new programs that assess taxpayers' non-compliance risk based in part on the strength of their tax governance.

Virtually all respondents say that their board and C-level executives have some level of awareness about the global tax transparency debate. For the most part, directors and senior executives engage in internal dialogue on the topic but say they are unconcerned about its potential impact on their company. Nearly one-quarter are highly engaged and concerned about the potential implications and actions they should consider.

High awareness, low concern – a blind spot?

The high awareness and low concern about the impact of tax transparency may suggest that directors and senior management have confidence in the effectiveness of their tax people, processes and controls and think other areas are more deserving of their attention.

The company's customer base may also influence the degree of concern among boards and upper management. Compared to business-to-business companies, which represent the majority of survey respondents, business-to-consumer companies tend to be more susceptible to reputational risk, such as consumer boycotts, due to their higher public visibility and greater vulnerability to negative public opinion. This is particularly true for digital economy companies, given the younger demographics of their consumer base.

Despite high levels of awareness, it seems that some boards and upper management may not fully appreciate the intricacies of their company's tax position. In some cases, directors may not realize how much their effective tax rate could change in a post-BEPS world and the impact on their earnings per share, for example, due to potential changes to permanent establishment principles and allocations of function and risk for transfer pricing purposes. The biggest concerns for tax executives in this area are explored in the next section.

Fewer than one in three tax executives surveyed say their company has both a written tax code of conduct and a formal tax risk management policy.

23% of tax directors say their company directors and senior executives are aware of and concerned about the potential impact of the tax transparency debate.

"This lack of upper-level concern suggests that boards and upper management do not fully appreciate the implications of more public and media scrutiny of their tax affairs. It also suggests a possible blind spot where tax authorities are concerned."

Tax executives' top concerns

From transfer pricing and treaty shopping to hybrid mismatches and the double non-taxation of digital transactions, the 15 points of the OECD BEPS Action Plan aim to refine a broad range international tax principles and address a number of tax planning structures and techniques.

Which aspects of the Action Plan worry tax executives most? In rank order, the greatest concerns are:

1. transfer pricing rule changes
2. tax information disclosure requirements
3. changes to international tax rules.

Tax directors' top concerns appear to be well placed. Individual countries could impose BEPS-related changes for transfer pricing documentation and country-by-country reporting with effect as early as tax years starting in 2014. The ability to gather the necessary data and the implications of reporting it could present significant challenges in the near term, as discussed below. Changes to international tax standards could result in the elimination of longstanding tax-friendly regimes in countries such as Luxembourg, the Netherlands, Ireland and the Caribbean.

Transfer pricing documentation

The OECD has proposed that transfer pricing documentation include a discussion of the taxpayer's worldwide transfer pricing structure, including a description of the ownership of intellectual property. Almost half of the tax directors surveyed do not believe such a requirement would create any concerns about their company's tax profile. In fact, some may welcome the relative simplicity of preparing a single master file to cover all of their transfer pricing documentation obligations.

However, a significant minority of tax executives believes that such proposal would create concerns about their tax profile. In particular, companies with high value intellectual property, such as digital economy, retail and pharmaceutical companies have good reason for concern. Detailed documentation of a taxpayer's worldwide transfer pricing structure could reveal unexpected results, such as previously unidentified centers of profit or property holdings. Tax authorities are expected to scrutinize this documentation closely to ensure their jurisdiction is receiving what they perceive to be an appropriate amount of tax. The process by which this detailed information would be made available to tax authorities outside the company's resident country was not known when the survey was conducted.

Intellectual property holdings

It seems likely that the OECD will endorse a substance-over-form approach to intellectual property holdings and allocations of profit. About 16 percent of tax executives say their company holds intellectual property in a low-tax jurisdiction. Over one-third of them are somewhat or very concerned that the OECD Action Plan might restrict or eliminate the ability of the company to continue holding their intellectual property in this manner.

***28%** of respondents say the OECD's transfer pricing documentation proposal would create concerns about their tax profile.*

"Detailed documentation of a taxpayer's worldwide transfer pricing structure could reveal unexpected results, such as previously unidentified centers of profit or property holdings. Tax authorities are expected to scrutinize this documentation closely."

***36%** of companies that hold intellectual property in low-tax jurisdictions are concerned the OECD BEPS Action Plan could cause their structure to be restricted or eliminated.*

***39%** of companies use hybrids for tax planning and worry that the BEPS Action Plan might restrict or eliminate their use of such planning.*

Hybrid instruments and structures

Tax planning with financing structures that involve hybrid instruments and structures are a clear target of the BEPS Action Plan. Almost two-thirds of respondents report having such structures currently in place, and 39 percent are concerned that the BEPS Action Plan might restrict or eliminate their use of such financing structures currently in place. However, 24 percent of respondents do not expect any impact on their hybrid financing structures.

The current consensus among OECD BEPS Action Plan participants is that tax planning involving hybrids could soon be a thing of the past. Special legislation imposed by many European Union member countries has already thwarted much of the planning involving hybrids within the EU. Other unilateral measures, such as anti-hybrid legislation, thin capitalization rules and anti-abuse rules, are expected to reduce hybrid planning opportunities even more.

For example, the UK has had anti-hybrid rules in place for some time, so such arrangements are now extremely rare for outbound UK tax planning purposes. At the same time, the UK is eliminating much of the impetus for UK-headquartered companies to engage in such techniques by taking steps to improve its tax competitiveness. The country's low headline tax rate, its move to a territorial-based tax system and relatively benign controlled foreign company regimes, and investment-friendly tax policies (e.g., patent box regime, research and development incentives) allow UK-based companies to arrive at a relatively low effective tax rate without aggressive tax planning.

Given the hostile climate toward aggressive tax planning in general over the past several years, many companies have already unwound their more aggressive tax strategies involving hybrids and adopted more conservative structures.

Will higher tax bills and compliance burdens result?

One of the big unknowns about the OECD's work on the tax challenges associated with the digital economy is whether the total tax burden and reporting obligations of global companies will ultimately increase. The survey results reflect this uncertainty, with respondents divided between those who expect higher overall tax charges and compliance burdens (41 percent), those who don't (31 percent), and those who simply do not know (26 percent). The majority of respondents, however, do expect their total tax burden and reporting obligations to increase.

In addition to potential changes for digital transactions, the net effect of the OECD BEPS Action Plan and unilateral tax reforms is likely to be increased overall tax costs and compliance requirements. Action in the areas of transfer pricing documentation and country-by-country reporting initiatives discussed above will undoubtedly increase compliance burdens, and new principles of setting transfer prices could ultimately increase total tax costs. Other examples include:

- Changes to prevent artificial avoidance of permanent establishment status could cause more companies to have a taxable presence in more jurisdictions.
- Stricter business substance requirements could cause some companies to incur costs of adding or relocating resources to some locations or moving their holdings to another location.
- Stricter thin capitalization rules and earnings stripping regimes could reduce the availability of tax-effective cross-border financing structures.

The OECD BEPS Action Plan's ultimate goal is to instill more uniformity and certainty in the international tax system, but, as noted, the extent to which this will be achieved is unknown. While most tax directors would welcome global tax consistency, this goal could be compromised by the need to forge consensus within the Action Plan's short timeframe, and companies could bear higher tax and compliance costs as a result.

For example, the OECD's country-by-country reporting guidelines offer a clear model for globally consistent, administratively efficient disclosure regimes. However, the OECD's decision against mandating a common reporting language (i.e., English) opens the door for greater complexity and increased costs in producing multiple local-language versions of these disclosures for all of a company's countries of operation.

Devil in the details

The tight timeframe also raises the risk that countries can only agree on high-level, generic principles. The lack of detail could allow plenty of room for divergent interpretation on adoption, leading to fragmented implementation among regions and individual countries.

For example, some countries, such as the UK, Luxembourg and Singapore, are likely to resist pressure to discontinue their various tax incentive regimes. Without shared definitions about what incentives are multilaterally accepted, other countries may characterize these incentives as promoting double non-taxation and enact specific anti-avoidance rules to deny their benefits.

Further, much of the OECD's focus on BEPS has concerned flows of taxable profits from higher to lower-taxing jurisdictions. Governments involved in the OECD's work have not developed a clear idea of how the Action Plan could affect the flows of taxable profits between higher-taxing countries – which are much more significant. For example, net exporters of intellectual property, such as the United Kingdom, currently gain a higher share of taxes from royalty flows. How changes to the tax principles involving profit allocation will affect the taxation of these royalty flows and effective tax rates more broadly is unknown.

The next section discusses what companies are doing in response to the OECD Action Plan.

"While most tax directors would welcome global tax consistency, this goal could be compromised by the need to forge consensus within the Action Plan's short timeframe, and companies could bear higher tax and compliance costs as a result."

Steps taken in response to the Action Plan

What steps are tax executives taking to get ready for the international tax changes the OECD BEPS Action Plan may bring? Generally, companies sit somewhere between two endpoints.

- At one endpoint are companies that are maintaining current structures so they can enjoy the benefits of these arrangements for as long as possible.
- At the other endpoint are companies that are unwinding structures, adopting more conservative tax positions, and reducing their exposure to reputational risk.

In terms of their response to the BEPS Action plan, tax executives say the most significant proactive steps are (in rank order):

1. determining that documentation and compliance is adequate
2. reviewing tax planning and operations
3. increasing efforts to take part in shaping policy.

Engaging with the process

Each of these actions is a vital element to any forward-thinking BEPS response plan. While the first two items should be routine for any high-performing tax function, the OECD's project offers a unique opportunity to contribute to international tax policy development. A sizable minority of tax directors appears to be embracing the chance to air their concerns and ensure their issues are being considered through various business forums.

Other key resources that tax executives have available to deal with BEPS and tax transparency issues include:

- A comprehensive resource to monitor BEPS-related developments, including country updates on proposed and enacted tax law changes
- A benchmarking analysis to help assess the activities of other companies in their peer group/industry.

***11%** of survey respondents say "no activity is planned until actual tax changes occur".*

***18%** say that one of their top three steps is to "review tax planning and operations".*

***18%** of tax directors have access to a forum sharing leading practices and collaborating on tax policy development.*

Tax health check: Top 5 items for review

What can tax directors do now to prepare for the coming wave of change? In the next section of this report, you'll find general advice that all companies should think about, no matter where they operate. In examining their existing tax arrangements, international companies should give high priority to five specific areas:

1. Prepare your **strategy for communicating your tax position** to your various stakeholders and decide what to communicate, to whom, where and when.
2. Develop a central approach to **transfer pricing** and prepare processes and tools to enable **country-by-country tax reporting.**
3. Consider threats to existing **hybrid entities and structures** and investigate potential alternatives.
4. Ensure there is sufficient **business substance** in offshore business structures, especially those involving intellectual property held in low- or no-tax jurisdictions.
5. Review the extent and nature of your **business presence in foreign jurisdictions** in light of potential changes to existing permanent establishment concepts.

Above all, given the quick pace of the OECD BEPS project, companies should closely **monitor developments** and their **potential impact** on their tax processes and planning arrangements. They should also **take a proactive role in BEPS consultations** to ensure practical business issues are raised and considered early in the process.

Getting ready for BEPS – KPMG's view of leading practice

Given current global tax developments, all signs suggest that we will continue to see increased pressure for more scrutiny of international transactions and structures, more transparency between taxpayers and the tax authorities, and more disclosure by companies on how much and where they pay tax. No matter what tax changes result from the OECD BEPS Action Plan or where your company does business, leading practice will involve a tax management strategy that drives how your company communicates about tax, governs its tax affairs and manages tax risk.

The following actions are key, regardless of industry or location.

- **Stay informed** – Keep on top of developments as they occur locally and internationally. Consider how these developments could affect your tax positions and planning.
- **Get involved** – Engage in BEPS-related consultations to ensure your practical business issues are raised and considered. Effective, widely accepted solutions can only be forged through broad consultation with tax professionals in business, government and public practice.
- **Conduct a tax health check** – Review your existing tax transactions and structures immediately to identify potential weaknesses, and take measures to rectify these areas. Identify potential weaknesses according to the BEPS Action Plan and take steps to make improvements. This includes movement of functions, assets and personnel within the group, development of legal, tax and transfer pricing documentation as support, and preparation of internal controls and working guidelines to mitigate tax risks. With adequate preparations, multinational corporations will be able to adapt to the new tax landscape created by BEPS without causing unwarranted disruptions in business operation or incurring excessive amounts of tax costs during the transition.
- **Prepare for questions** – Be prepared to comment on your business and tax activity at any given moment – a particularly important capability in the era of social media). Ensure board members, C-level executives and the core tax team are aware of potential questions and challenges that could come from any number of stakeholders such as regulators, investors, media and the general public.
- **Think reputational risk** – Ensure that decisions around tax are made taking into account potential reputational risks and not simply whether your organization has complied with the tax laws in various jurisdictions.
- **Assess your company's relationship with tax authorities** – Ensure that there are appropriate, open and respectful relationships with local tax authorities in all countries in which you operate.

Contact us

For more information about this survey or to explore the potential of BEPS-related developments on your business, please contact your usual KPMG International Tax contact or one of the professionals listed below.

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Designed by Evalueserve.
Publication name: OECD BEPS Action Plan – ready or not?
Publication number: 132080
Publication date: January 2015