The G20/OECD BEPS Crusade

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The G20 and OECD are leading a crusade against alleged abusive international tax planning.

Two years ago, on February 12, 2013, the G20, in collaboration with the Organization for Economic Cooperation and Development ("OECD"), unleashed a ferocious attack on what they allege is abusive international tax planning by Fortune 500 and other leading multinationals.

That attack took the form of adopting, as subsequently detailed on July 19, 2013, a three-year plan to develop a 15-part action plan to counter the perceived tools of abusive tax planning (or "tax avoidance") – namely, base erosion and profit shifting ("BEPS").

This commentary briefly examines the background to (and current status as of January 31, 2015) of the anti-BEPS initiative.

Background

Tax planning has been around for as long as there has been taxation. In a domestic context, the entente between the right to tax plan and the statutory prohibition laid down by the "general anti-avoidance rule" (GAAR) (s. 245 of the *Income Tax Act* (the "Act")), as well as the relative ease with which specific anti-avoidance rules can be developed to counter obvious deficiencies in the domestic tax statute concerning domestic transactions, establish a relatively secure tax base for the government of Canada and, in comparable domestic contexts, for the governments of other similarly situated countries (from an economic/business standpoint).

That equation is appropriate where there is a clear loser (the government – although not necessarily the economy) for each dollar of tax saved by taxpayers in the domestic context. But, the international business scene entails a substantially different context for evaluating the effects of tax planning and, consequently, the anti-tax planning rules and tools that ought to be developed and deployed.

That is because the overall taxation of a two- (or more) country transaction will turn on the interrelated effects of the tax policies and rules of the two (or more) countries involved.

Historically, the policies and rules (particularly the policies) have been crafted with regard to the concerns and objectives of the country involved generally *without* regard to those of the other country to the transaction.

Double (or no) taxation

This state of affairs has presented multinationals with a dual-edged sword. The lack of integration/coordination of differing tax systems can either give rise to the risk of double taxation or the opportunity for *no* taxation.

The former was recognized long ago and steps have been taken over the years to provide protection/relief from double taxation through unilateral domestic legislation (i.e., the foreign tax credit in s. 126 of the Act or through bilateral tax treaty arrangements providing procedures to resolve double tax issues).

But, to the good fortune of multinationals, there traditionally had been no focus on the (quite legal) opportunities available in international business to pay no tax to any country. And, perhaps that has been so *because* there generally is no *obvious* (government) loser where a transaction escapes taxation in all of the countries involved. That result can, at times, be seen to totally accord with the tax/fiscal policies of the countries involved.

Fiscal interests

A December 2008 report by a blue chip advisory panel (chaired by the former CEO of Scotia bank, Peter Godsoe, and commissioned by the Department of Finance) on the future of Canada's international tax rules recommended that Canada retain (and, indeed, extend (in some respects)) its long-standing policy of promoting the international competitiveness of its multinationals by exempting most foreign subsidiary profits from Canadian tax. This recommended exemption includes those profits arising from inter-foreign subsidiary arrangements designed to *reduce* taxes payable to countries in which such subsidiaries operate. (See, for instance, ss. 95(2)(a)(ii) and 113(1)(a) of the Act.)

If the latter is combined with the tax policy of a country such as the United States that seeks to encourage foreign investors by, for example, allowing interest on acquisition debt to be deductible against the U.S. profits of a U.S. target, a structure (that may involve a third country such as Luxembourg) can readily emerge for a Canadian acquisition of a U.S. target that sees significant portions of the post-acquisition profits of the target not being subject to material tax in any of the countries involved and *without* any of the relevant governments being "losers" as a result thereof, in light of the separate fiscal interests of each.

Status

But, notwithstanding the foregoing, a random confluence of headline media reports in 2011-2012 of the international tax planning initiatives of Apple, Google and other leading multinational enterprises ("MNEs") (often involving Ireland, Luxembourg and the Netherlands), as well as initiatives by certain anti-big business politicians, NGOs, academics and think tanks, led to the Feb 2013 BEPS crusade.

See International Taxation, page 95

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 continued from page 94

"The BEPS crusade seeks to effectively stamp out international tax planning by developing and coordinating relevant blueprints for how countries would each amend their domestic tax statutes and enter into revised bilateral or multilateral income tax agreements (treaties).

That crusade seeks to effectively stamp out international tax planning by developing and coordinating relevant blueprints for how countries would each amend their domestic tax statutes and enter into revised bilateral or multilateral income tax agreements (treaties). To be clear, there is no basis upon which the G20 or OECD could force any member states to adopt such a change, a fact admitted by the OECD/BEPS chief, Pascal Saint-Amans, who has referred to commitment to the BEPS project as nothing but a "moral obligation."

Recommendations

Amid a constant and enormous stream of position papers, press releases, public consultations, interviews and such from the OECD, the BEPS initiative has seen both preliminary and advanced (but generally not final) recommendations put forward to "improve" and/or create new domestic and/or treaty rules to counter and eliminate tax planning/avoidance that allegedly stems primarily from current deficiencies in domestic laws and/or treaties in (or in respect of) the following areas:

- the allegedly inappropriate ways in which MNEs take advantage of differing ("hybrid") treatment, in different countries, of certain entities (as between corporations or transparent flow throughs) and of certain securities (as between equity or debt) and of repo transactions (as between secured financing and the sale and then repurchase of equity securities);
- the alleged exploitation of perceived weaknesses in the laws governing inter-company transactions (i.e., transfer pricing rules) particularly in relation to high-value intangibles and inter-company financings (apart from those contemplated in and by the "hybrid" area);
- the alleged inappropriate manipulation of current treaty rules defining and taxing "permanent establishments";
- the alleged inappropriate uses that are made of treaties (i.e., treaty shopping and other stratagems involving treaties);
- the alleged inappropriate results that can arise from the failure of tax systems to keep up with (and adapt to) electronic commerce; and
- the alleged lack of rules that require sufficient provision of information to tax authorities as allow them to ferret out nefarious tax avoiders (and, separately – unrelated to legal tax planning – tax evaders).

The OECD is aiming to finalize recommendations in most areas by the end of this year. It is ironic that while a concern of the G20/OECD (well-founded in this writer' s view) is that not all countries will sign on, some countries have "jumped the gun."

Inspired by the crusade-like euphoria and enthusiasm of the BEPS activity, these countries are proposing unilateral changes to their tax system (i.e., the UK's proposed "Diverted Profit Tax", apparently aimed at folks like Google and perhaps Starbucks).

Tax rulings

The EU has adopted the radical strategy of questioning, under illegal state-aid principles, tax rulings that some countries (Ireland, Luxembourg and the Netherlands) issued to Apple, Fiat, Amazon, Starbucks and others. It is also threatening to require that such countries ratchet back (for up to ten years) tax benefits stemming from such rulings.

Fuelling this initiative was a leak of the names of hundreds of leading MNEs who had received rulings from Luxembourg and a subsequent decision by the EU to require each country to disclose rulings they have granted. (With respect to Canadian entities caught up in unauthorized disclosures, see the *Financial Post* op-ed cited at the end of this article.)

Significance

All in all, it is premature to say whether the BEPS initiative will have the effects its sponsors had in mind and foresaw when unveiling it two years ago; but, if the space it has taken up and the noise it has generated were the criteria for success, it would already be viewed as a tremendous success.

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