

International Coordination – Thursday, May 22, 2014¹

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Panel: Brian Ernewein, Department of Finance Canada (CA)
Arlene Fitzpatrick, US Treasury (USA)
Douglas Poms, US Treasury (USA)
Vance Sider, Thomson Reuters (USA)

The BEPS Process

The Panel discussion focused on the joint base erosion and profit shifting (BEPS) initiative between the OECD and the G20. The presentation included a brief status update and summary of the BEPS Action Plan, including the discussion drafts on Transfer Pricing Documentation, Preventing Treaty Abuse, Neutralizing the Effects of Hybrid Mismatch Arrangements, and the Tax Challenges of the Digital Economy that were released in January-March of 2014.

The panellists commented on how the BEPS process is working in Canada and in the United States. The government panellists confirmed that both Canada and the US are involved in the work being done by the OECD focus groups, participating with other countries in drafting and reviewing the discussion drafts, and emphasized that those discussion drafts are intended for comment and are by no means a final product. The panellists noted that both Canada and the US are interested in receiving input from stakeholders on the various proposals, and that the process is one of time-intensive, active engagement. From an industry perspective, many tax executives are involved in one or more multinational coalitions for the purpose of conveying industry views on the BEPS action items to the OECD, and have been very impressed by the engagement of the OECD and public officials.

In Canada, the 2014 federal budget launched a very general consultation on BEPS, having chosen this approach rather than obtaining “input on precise proposals when it’s precisely too late”. Interested parties were invited to provide comments prior to June 11, 2014.

The panellists also discussed the objectives of the BEPS project, noting that dispensing with wasteful tax disputes and improving the integrity of the tax system were important goals.

Preventing Treaty Abuse

The panellists discussed domestic and international efforts to prevent treaty abuse. Before the BEPS action item on treaty abuse was announced, Canada had already commenced its own study on preventing treaty shopping. The panellists discussed the merits of a subjective, purpose-based anti-abuse rule as compared to US-style limitation on benefits provisions, as well as the difficult question of when domestic rules are consistent with, and when they impermissibly seek to override, bilateral treaty obligations.

It was noted that multinational enterprises consider a variety of factors in deciding where to locate activities and operations. The panellists considered whether a local tax regime would be a valid consideration when evaluating whether a “main purpose test” has been satisfied or whether

¹ This summary of the panel discussion was prepared by Amanda Heale of Osler, Hoskin & Harcourt LLP as rapporteur, and was not prepared or authored by the panellists.

derivative benefits should be available (i.e., whether tax costs should be treated in a manner consistent with manufacturing costs or other business expenses that may be relevant when deciding where to locate business activities).

Hybrid Mismatch Arrangements

At a high level, the approach taken in the OECD discussion draft on hybrid mismatch arrangements is to adopt a primary rule and a secondary, defensive rule to deal with these arrangements. The OECD working group has held focus group meetings to develop the recommended rules as well as public comment sessions. The panellists discussed the prospects of the US and Canada adopting the approach set out in the discussion draft.

It was noted that the approach of having a primary and secondary rule could be complicated by transitional issues: if Country A has proposed to adopt a rule with effect once proposed, but that rule has not been enacted, will Country B apply its secondary rule, with the possibility of double taxation? It was agreed that the fact that these rules could be coming into effect in multiple jurisdictions with different timetables adds complexity. The panellists noted the OECD is considering how to address such transitional concerns.

The panellists also discussed whether the interaction between Article IV(6) and (7) of the Canada-US treaty and any domestic hybrid mismatch rules could lead to double taxation. The panellists noted that the intention of the proposed rules is to discourage hybrid mismatch arrangements. In this regard, the panellists discussed the scope of the rules, observing that the current focus of the OECD is on related party transactions and structured transactions, whereas there is not yet consensus as to whether the proposals should apply to “accidental hybrids” and normal course arm’s length dealings.

The Digital Economy

The panellists discussed whether it would be practical or appropriate to ring fence the “digital economy” and develop special rules applicable to that economy such as the “virtual PE” proposal, rather than re-evaluating structural features of the tax system such as the permanent establishment concept more broadly. The panellists distinguished this issue from the issues of adjustments to domestic rules dealing with highly mobile income, as well as separate consumption tax rules dealing with digital goods or services.

Transfer Pricing Documentation

The panel noted that concern has been expressed that country-by-country reporting will lead tax authorities or legislators to stray from the arm’s length principle and more frequently adopt special measures, and potentially lead to an explosion in transfer pricing disputes. It was agreed that country-by-country reporting is intended to be a high-level risk assessment tool, and not “a way to back into formulary apportionment”. The intention is for countries to respect the arm’s length principle and only resort to special measures in limited circumstances.

Other Action Items

With respect to 2015 BEPS action items, it was noted that the OECD is working on the various 2015 deliverable items including the action items in respect of controlled foreign company

(CFC) rules and interest expense. One option under consideration for interest expense is the application of a multi-country interest expense allocation and cap. If adopted, such an approach would impact other action items, such as hybrid mismatch arrangements. It was also observed that work on the permanent establishment definition is ongoing, and would be relevant to the digital economy action item. In terms of the pace of work on BEPS, the panel expressed the expectation that 2015 will be similar to 2014, with much work to be done.