OECD BASE EROSION AND PROFIT SHIFTING PROJECT
IN AN IRISH CONTEXT

Part of the Economic Impact Assessment of
Ireland’s Corporation Tax Policy

Department of Finance
October 2014
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Introduction

This paper seeks to provide background to and explore the potential impacts of the Base Erosion and Profit Shifting (BEPS) project that is currently being undertaken by the OECD.\(^1\)

This paper is part of a wider review of Ireland’s corporation tax policy undertaken by the Department of Finance.

Section 1 provides a background to the BEPS project and outlines the various actions and their deadlines.

Section 2 summarises the reports that were published and discussed at the G20 meeting in September 2014.

The reports that are due to be finalised in 2015 are discussed briefly in Section 3 which is followed by a discussion in Section 4 of the interactions of the BEPS project and EU law.

Section 5 of the paper provides a summary of the results of the public consultation, which sought comments from the public in relation to Ireland’s response to the BEPS project.

Following on from the results of the consultation and the publication of the various 2014 reports, Section 6 discusses the potential impact of the BEPS project for Ireland.

This section is then followed by the glossary of terms contained in Section 7.

The paper also contains a number of boxes that provide insight into some broader items such as EU action in certain areas. They are included so that the reader is provided with a broader perspective on BEPS and the current international tax milieu.

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The analysis and views set out in this paper are those of the authors only and do not necessarily reflect the views of the Department of Finance or the Minister for Finance.

\(^1\) Together with other Non-OECD G20 Members, including Brazil, Russia, India, China and South Africa.
1. Background to the BEPS project

Introduction to the BEPS project

1. Globalisation, digitalisation, the fluid movement of capital and rapidly changing business models have all been factors that allow companies to exploit gaps in international tax rules to avoid taxation through a reduction of their taxable base by shifting profits to low/no tax jurisdictions.

2. The need for a multilateral solution has been recognised and the G20 has mandated the OECD to develop recommendations on how to tackle aggressive and harmful international tax planning. This is known as the OECD Base Erosion and Profit Shifting (BEPS) project. This project has two key pillars which are:

   1) to align, more strictly, substance and taxing rights; and

   2) to address double non-taxation.

3. When a company undertakes base erosion it is attempting to reduce its taxable income and thereby reduce the amount of tax it has to pay. The practice of profit shifting is to move profits from one jurisdiction to another. This is advantageous where the taxable profits are moved from a high tax jurisdiction to a low/no tax jurisdiction (because there is a saving due to the difference in tax rates).

4. In July 2013 the OECD launched an Action Plan on Base Erosion and Profit Shifting (BEPS), identifying 15 specific actions to equip governments with the domestic and international instruments to address these challenges. This Action Plan was endorsed by the G20 Finance Ministers and Central Bank Governors at their July 2013 meeting in Moscow as well as by the G20 Heads of State at their meeting in Saint-Petersburg in September 2013. It is important to note that non-OECD G20 members are also involved in the BEPS project on an equal footing.

5. The BEPS project is not seeking to harmonise tax policy across participant countries.

   “Tax policy is not only the expression of national sovereignty but it is at the core of this sovereignty, and each county is free to devise its tax system in the way it considers most appropriate.”

6. Further, the project is not directed against tax competition between countries but instead against harmful tax competition measures adopted by jurisdictions. It is fundamentally important to distinguish between these two types of tax competition. For instance a low rate of tax, such as the 12.5% trading rate in Ireland, is a competitive tax lever that can be used by countries, especially smaller, peripheral countries that increasingly look to FDI for growth.

7. The 1998 OECD report on harmful tax competition confirmed that a low tax rate on its own is not necessarily a sign of a harmful regime. For a regime to be considered harmful a number of the following 4 key criteria must be present (these criteria are discussed in more detail in section 2 below):

   a. no/low effective tax rate;

   b. a regime “ring-fenced” from the local economy;

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2 “Addressing Base Erosion and Profit Shifting”, Centre for Tax Policy and Administration, OECD
3 “Harmful tax competition – An Emerging Global Issue”, Centre for Tax Policy and Administration, OECD
c. a lack of transparency on the operation of the regime; and

d. a lack of effective information exchange with other countries on the regime.

It is regimes that display a number of these criteria which the BEPS project is seeking to address and it stems from these criteria that many of the income based intellectual property (IP) regimes adopted by various jurisdictions are currently being examined by both the BEPS project and the EU.

“Every jurisdiction is free to set up its own corporate tax system as it chooses. States have the sovereignty to implement tax measures that raise revenues to pay for the expenditures they deem necessary. No or low taxation is not per se a cause of concern unless it is associated with practices that artificially segregate taxable income from the activities that generate it. In other words, tax policy concerns arise when there are gaps in the interaction of different tax systems or when, the application of bilateral tax treaties allows income from cross-border activities to go untaxed.”

8. It is also necessary to clarify that the BEPS project is not intended to be a big country versus small country project. Indeed, the fact that this project is being carried out by the OECD is critically important for smaller countries as they have a “seat at the table” and the same speaking rights as all other nations. The multilateral OECD approach is being used because of the belief that multilateral action is needed to effectively address these issues.

“Uncoordinated, unilateral action by individual countries to exert taxing rights over cross-border activity would only make the problem worse, resulting in double or multiple taxation, increasing disputes for business and among governments, and harming economic growth.”

OECD BEPS Action Plan timetable

9. The BEPS project is divided into 15 different actions with varying deadlines ranging from September 2014 to December 2015. However while at the outset it was deemed that this would be a phased approach it has become apparent that the BEPS project will be delivered as a package of measures in 2015 as there is significant crossover between the various actions.

10. The technical work on the BEPS actions is being undertaken by the OECD Committee on Fiscal Affairs (CFA) through its subsidiary bodies (as portrayed in the following figure):

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5 Testimony of Pascal Saint-Amans Director, Centre for Tax Policy and Administration (OECD), before the United States Senate Committee on Finance on July 22, 2014.
11. The full list of BEPS actions, together with their original proposed timetables is outlined below:

### Table of BEPS Actions

<table>
<thead>
<tr>
<th>Title of action listed in the Action Plan on BEPS</th>
<th>Description of actions listed in the Action Plan on BEPS</th>
<th>Forum where this action point is dealt with</th>
<th>Deadline</th>
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<tbody>
<tr>
<td><strong>Action 1. Address the tax challenges of the Digital economy</strong></td>
<td>Identify the main difficulties that the digital economy poses for the application of existing international tax rules and will develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation.</td>
<td>Taskforce on the Digital Economy</td>
<td>September 2014</td>
</tr>
<tr>
<td><strong>Action 2. Neutralize the effects of hybrid mismatch arrangements</strong></td>
<td>Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralize the effect (e.g., double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities.</td>
<td>Working Party (WP) 11 – focus group.</td>
<td>September 2014</td>
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<td><strong>Action 3. Strengthen CFC rules</strong></td>
<td>Develop recommendations to design CFC rules in such a way which would prevent profit shifting to low tax or no tax jurisdictions.</td>
<td>WP 11 – focus group</td>
<td>September 2015</td>
</tr>
<tr>
<td><strong>Action 4. Limit base erosion via interest deductions and other financial payments</strong></td>
<td>Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations.</td>
<td>WP 11 – focus group</td>
<td>September/December 2015</td>
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<tr>
<td><strong>Action 5. Counter harmful tax practices more effectively, taking into account transparency and substance</strong></td>
<td>Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime.</td>
<td>Forum on harmful tax practices.</td>
<td>Interim report – September 2014 September/December 2015</td>
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<tr>
<td><strong>Action 6. Prevent treaty abuse</strong></td>
<td>Develop model treaty provisions and/or model recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country.</td>
<td>WP 1 – focus group</td>
<td>September 2014</td>
</tr>
<tr>
<td><strong>Action 7. Prevent the artificial avoidance of PE status</strong></td>
<td>Develop changes to the definition of permanent establishment PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions.</td>
<td>WP 1 – focus group</td>
<td>September 2015</td>
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| Action 8. Intangibles | Develop rules to prevent profit shifting by moving intangibles among group members. This will involve:  
(i) adopting a broad and clearly delineated definition of intangibles;  
(ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation;  
(iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and  
(iv) considering updating the guidance on cost contribution arrangements. | WP 6 | Interim report- September 2014, September 2015 |
| Action 9. Risk and capital | Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. | WP 6 | September 2015 |
| Action 10. Other high risk transactions | Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to:  
(i) clarify the circumstances in which transactions can be recharacterised;  
(ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and  
(iii) Provide protection against common types of base eroding payments, such as management fees and head office expenses. | WP 6 | September 2015 |
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<tr>
<td>Action 11. Establish methodologies to collect and analyze data on BEPS and actions to address it</td>
<td>Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate and micro-level data, taking into account the need to respect taxpayer confidentiality and the administrative costs for tax administrations and business.</td>
<td>WP 2</td>
<td>September 2015</td>
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<tr>
<td>Action 12. Require taxpayers to disclose their aggressive tax planning arrangements</td>
<td>Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of “tax benefit” in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.</td>
<td>WP 11 – focus group</td>
<td>September 2015</td>
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<tr>
<td>Action 13. Re-examination of transfer pricing documentation</td>
<td>Develop recommendations regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that multinational enterprises (MNEs) provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.</td>
<td>WP 6</td>
<td>September 2014</td>
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<td><strong>Action 14. Make dispute resolution mechanism more effective</strong></td>
<td>Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases</td>
<td>WP 1 – focus group</td>
<td>September 2015</td>
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<tr>
<td><strong>Action 15. Develop a multilateral instrument</strong></td>
<td>Analyze the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument.</td>
<td>An informal group of experts will work on this aspect of the Action Plan with the OECD Secretariat.</td>
<td>Feasibility report-September 2014 Final report – December 2015</td>
</tr>
</tbody>
</table>

12. The 2014 BEPS package consisted of seven deliverables: two final reports (Action 1 and Action 15), one interim report (Action 5) and four reports containing draft recommendations (Actions 2, 6, 8 and 13) which are agreed and will be finalised following further work on implementation and interaction with the 2015 deliverables.
2. **Summary of the 2014 reports**

**Action 1: Address the tax challenges of the digital economy**

13. The key finding from the report on the digital economy is that “because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring fence the digital economy from the rest of the economy for tax purposes”.

14. The OECD Digital Economy report includes extensive background discussion of the development of the digital economy including emerging and possible future developments. This background and outline of chronological development is important in setting the scene for the key finding as it shows the increasing influence of the digital world on all aspects of the economy. It also discusses the spread and impact of information and communication technology across the global economy, provides examples of new business models and identifies the key features of the digital economy. These key features include:

   - mobility;
   - reliance on data;
   - network effects;
   - the spread of multi-sided business models;
   - tendency toward monopoly or oligopoly; and
   - volatility.

15. The report notes that while the digital economy does not generate unique BEPS issues, some of its key features exacerbate BEPS risks. The reasons for this include, among others, the mobility of intangible assets and the ability to make substantial sales into a market from a remote location with minimal use of personnel. However the Task Force on the Digital Economy (TFDE) (who prepared the digital Economy report) considered that these issues would be addressed under other BEPS actions as the main thrust of the project is to align taxing rights with real economic activity and value creation. The report specifically mentions the work being performed under actions 2 (hybrid mismatches), 3 (CFC rules), 4 (base erosion via interest deductions), 5 (harmful tax practices), 6 (treaty abuse), 7 (PE status) and 8-10 (transfer pricing outcomes in line with value creation). As the work on all of these actions has not yet been finalised, the TFDE will meet four times in 2015 to carry out further work on; a) getting a better understanding of the broader direct tax challenges raised by the Digital Economy; and b) further developing the potential options to address them. In addition, liaison groups have been set up between the TFDE and the other working parties dealing with Actions 3, 6 and 8-10 to ensure that relevant issues are considered.

16. Some of the digital economy’s key characteristics also exacerbate risks of BEPS in the context of indirect taxation. For such issues the task force has suggested that the implementation of the OECD’s Guidelines on place of taxation for business to business supplies of services and intangibles would serve to reduce such risks.

17. The digital economy also raises broader tax challenges for policy makers. These challenges relate in particular to nexus, data and characterisation. When discussing the digital economy data is an area about which there is huge debate. One side of the argument is that growing reliance on, and collection of, data “from users located in a jurisdiction ... should give rise to nexus with that

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6 “Report on the tax challenges of the digital economy”, Centre for Tax Policy and Administration, OECD
jurisdiction” and that data should be treated as valuable in itself. The other side of the debate contends that raw data is worthless without the intellectual property to be able to analyse it/evaluate it properly. This is an area which was discussed in length by the TFDE and is another area which will continue to be examined in 2015.

18. However while the task force has agreed to undertake further work in relation to these broader challenges there has been no consensus to date on whether any actions will be necessary and, to the extent they are necessary, what shape they would take.


Separate to the OECD BEPS project but on a related issue, the European Commission High Level Expert Group on Taxation of the Digital Economy was set up in November 2013 to examine the best approaches to taxing the digital economy in the EU, and look at the pros and cons of different approaches. The aim of the group was to identify the key problems with digital taxation from an EU perspective, and to present potential solutions. The report was published on the 28th May 2014. The group was chaired by Mr Vítor Gaspar, who is a former finance minister of Portugal. The group consists of a mixture of experts in taxation, economics, and the digital economy. The conclusions were:

1) There should not be a special tax regime for digital companies;
2) Digitalisation strengthens the case for simple, stable and predictable tax rules; and
3) Tax incentives and credits should be approached with caution and be carefully assessed both ex ante and ex post.

The report agrees with the view of the OECD’s task force that the digital economy cannot be separated from the rest of the economy and Ireland supports this view.

Action 2: Neutralise the effects of hybrid mismatch arrangements

19. Hybrid arrangements take advantage of a difference between the tax laws of two countries creating a mismatch between the two tax systems to the benefit of the taxpayer. The OECD report on hybrid mismatch arrangements7 seeks to address these mismatches by designing domestic rules, which could be implemented by member states, and also by suggesting some changes to the model tax treaty to combat these aggressive structures.

20. Hybrid mismatch arrangements generally take one of two forms:
   • hybrid instruments
   • hybrid entities

21. A hybrid instrument is an instrument (a loan or equity etc.) which is viewed, for tax purposes, in different ways by different jurisdictions. The most common example of a hybrid instrument is one which is viewed as debt in one jurisdiction and as equity in the other. Depending

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7 “Action 2 – Neutralise the Effects of Hybrid Mismatch Arrangements”, Centre for Tax Policy and Administration, OECD
on the tax laws of each of the jurisdictions, it is possible that any payments on the instrument could be characterised as deductible interest in one jurisdiction and as a non-taxable dividend in the other jurisdiction. Such a scenario results in a tax deduction being claimed in one jurisdiction with no corresponding inclusion for taxation purposes in the other jurisdiction – a deduction/no inclusion (D/NI) outcome, which is effectively a double non-taxation outcome.

22. Hybrid entities work in a different way. A hybrid entity is one which is viewed as transparent by the laws of one jurisdiction and opaque by the laws of another jurisdiction. Much like the hybrid instrument above, this potential mismatch can lead to a number of outcomes that are favourable for the tax payer. For example it is possible that a single payment made by a hybrid entity could be claimed as a deduction in two jurisdictions at the same time – such a situation is described as a double deduction (DD) outcome.

23. The examples explained briefly above are only two of many different scenarios that can result in D/NI or DD outcomes. Other types of scenarios are listed in the report and a technical explanation of the mechanics of their operation and counteracting rules is set out. Suffice to say that these hybrid scenarios are both technical and complex and as such a more detailed summary of all the different types is not warranted here.

24. The rules outlined in the report seek to address these D/NI and DD scenarios to try to ensure that companies are not benefiting from unfair tax advantages as a result of mismatches in the laws of different countries. The report is due to be complemented by a commentary which will be worked on by OECD Working Party 11 in 2015 and it will give a broader understanding of the intended operation of the rules.

25. The report also makes recommendations in relation to changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties. The report further outlines the interaction between the recommendations for domestic laws and the proposed changes to the model convention. However the report does note that a number of the proposals resulting from the work on Action 6 (Preventing Treaty Abuse) may play an important role in ensuring “that hybrid instruments and entities are not used to obtain the benefits of treaties unduly”.

### Changes to the EU Parent Subsidiary Directive – the EU’s response to Hybrids

The EU, through changes agreed in 2014 to the parent subsidiary directive (PSD), have addressed hybrid mismatch outcomes resulting from hybrid loan structures. The purpose of the PSD, when it was introduced, was to eliminate double taxation on the same income within a group of companies that are based in different member states. The directive operates to provide an exemption from withholding tax on distributed profits in the payer state and a credit or exemption in the recipient state.

However, as with the mismatches being targeted by BEPS Action 2, the PSD rules were open to manipulation and as such could lead to deduction/no inclusion outcomes. Accordingly, developing from work undertaken during Ireland’s successful Council presidency in 2013, discussions on an amending directive commenced to address concerns regarding the use of hybrid loan structures in aggressive tax planning.

Agreement was reached on the hybrid loan element in 2014, and all member states will have to implement the rules into their domestic legislation by 31 December 2015 at the latest. However it is not expected that changes to the PSD in relation to hybrid loan structures will have significant
impact in Ireland, as we do not exempt inbound dividends from other EU jurisdictions, but instead use the credit method to allow double tax relief for foreign tax incurred.

Discussions are continuing in 2014 in respect of proposals to introduce general anti-abuse rules into the PSD.

The EU is also looking at the area of hybrid entities through the Code of Conduct Group. Ireland’s 2013 Presidency work on this area focused on developing guidelines to address the first tranche of that work – intra-EU hybrid entity mismatches – and these guidelines have been taken into account and are compatible with the subsequent OECD BEPS work and recommendations.

**Action 6: Prevent treaty abuse**

26. Treaty abuse, and particularly treaty shopping, is being targeted by Action 6 of the BEPS project. A multinational group can engage in treaty shopping by using conduit jurisdictions to benefit from more favourable treaty provisions. This can be explained through the following example:

27. A company in Jurisdiction A is due to receive a payment from a company in Jurisdiction B. There is no tax treaty between jurisdictions A & B meaning that this payment would be subject to withholding tax in jurisdiction B. However jurisdiction C has a tax treaty in place with both A & B, which means that were the payment to flow through jurisdiction C it would obtain treaty benefits (i.e. reduced or no withholding tax).

28. In order to try to counteract this type of abuse the OECD report on treaty abuse suggests two main rules which could be adopted by countries in their treaties. These two rules are a limitation on benefits (LoB) clause and a principal purpose test (PPT). The report suggests that a minimum standard could be agreed, however consensus has not been reached as to what this minimum standard should

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8 “Action 6: Preventing the granting of treaty benefits in inappropriate circumstances”, Centre for Tax Policy and Administration, OECD
be, i.e. whether either rule would be sufficient on its own or whether some form of both would be needed. Further work will be done in relation to “the contents of the model provisions and the relevant commentary, in particular the limitation on benefits rule”.

29. The LoB article contains a number of different tests which allow a company to qualify for benefits under the treaty. The tests are largely objective tests of qualifying residence status by virtue of ownership, or business substance that must be satisfied. A relieving provision is also included which allows the competent authority to grant treaty benefits in certain cases. There is no consensus on the inclusion of a derivative benefits test, which generally would provide that if a non-qualifying treaty country resident is owned by parties which would themselves be eligible for the benefits of the treaty, or another treaty with no less favourable terms, then the treaty may still apply. The inclusion of such a test is clearly very important for smaller countries.

30. The PPT seeks to disallow the treaty benefits where one of the main purposes is securing a treaty benefit. This rule is designed to address other forms of treaty abuse, including treaty shopping and conduit financing arrangements that would not be covered by the LoB provision.

31. A key change made to this report (compared with the public discussion draft) was the inclusion of options for countries who do not wish to deprive collective investment vehicles (CIVs) of treaty benefits. The working party has acknowledged that denying treaty benefits to CIVs under the LoB rule would contradict the conclusions of the 2010 Report on the Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles (the “2010 report”). In this regard, the draft LoB includes a possible CIV exception based on the various options included in the 2010 report.

32. Some business groups have argued that CIVs should be entitled to treaty benefits without any condition. However, this uniform solution was rejected by the 2010 report reflecting concerns that it may facilitate treaty shopping. Therefore, the 2010 report contains various options which the Treaty Abuse Report suggests could be included in the draft LoB based on the agreement of the treaty partners.

33. Further work in relation to this area and in relation to the application of the measures to other types of funds will take place over the coming year.

34. In addition to a proposed new Article containing an LoB and / or a PPT, the report contains proposals for some specific anti-abuse measures in existing Articles of the Model Tax Convention e.g. proposed changes to the tie-breaker test in Article 4.

**Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance**

35. Work in this area is being carried out by the Forum on Harmful Tax Practices (FHTP) which is an OECD group that pre-dates the BEPS process. The OECD report on harmful tax practices is an interim report and gives an update as to the progress that has been made by the FHTP in the area of identifying harmful tax practices. The FHTP are looking at preferential regimes and are analysing these regimes, in operation in different forms across various member states, to determine whether they are

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9 “Explanatory statement on the 2014 BEPS deliverables”, Centre for Tax Policy and Administration, OECD
10 “The granting of treaty benefits with respect to the income of collective investment vehicles”, Centre for tax policy and administration, OECD
11 “Countering harmful tax practices more effectively, taking into account transparency and substance”, Centre for tax policy and administration, OECD
potentially harmful or not. As has been mentioned above, the 1998 report by the OECD on harmful tax competition used four key factors in identifying and assessing harmful preferential tax regimes (these, along with an explanation of each is set out in the box below). In that report the OECD also suggested that the following question needs to be asked in relation to these regimes:

*Is the presence and level of activities in the host country commensurate with the amount of investment or income?*

36. This question suggests that substantial activity would be necessary in order for the regime not to be deemed harmful. In the current interim report, while there is agreement in relation to the need for this substantial activity there is no final decision on how such activity should be quantified. At present it appears that the two main approaches are the transfer pricing approach and the nexus approach.

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**Key factors in identifying and assessing harmful preferential tax regimes**

**a) No or low effective tax rates**
A low or zero effective tax rate on the relevant income is a necessary starting point for an examination of whether a preferential tax regime is harmful. A zero or low effective tax rate may arise because the schedule rate itself is very low or because of the way in which a country defines the tax base to which the rate is applied. A harmful preferential tax regime will be characterised by a combination of a low or zero effective tax rate and one or more other factors set out in this Box and, where relevant, in this section.

**b) “Ring fencing” of regimes**
Some preferential tax regimes are partly or fully insulated from the domestic markets of the country providing the regime. The fact that a country feels the need to protect its own economy from the regime by ring-fencing provides a strong indication that a regime has the potential to create harmful spillover effects. Ring-fencing may take a number of forms, including:
- a regime may explicitly or implicitly exclude resident taxpayers from taking advantage of its benefits;
- enterprises which benefit from the regime may be explicitly or implicitly prohibited from operating in the domestic market.

**c) Lack of transparency**
The lack of transparency in the operation of a regime will make it harder for the home country to take defensive measures. Non-transparency may arise from the way in which a regime is designed and administered. Non-transparency is a broad concept that includes, among others, favourable application of laws and regulations, negotiable tax provisions, and a failure to make widely available administrative practices.

**d) Lack of effective exchange of information**
The lack of effective exchange of information in relation to taxpayers benefiting from the operation of a preferential tax regime is a strong indication that a country is engaging in harmful tax competition.

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37. One of the key themes of the harmful tax practices report is a focus on intangible regimes.

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12 “Harmful tax competition – An Emerging Global Issue”, Centre for Tax Policy and Administration, OECD
13 “Harmful tax competition – An emerging global issue”, Centre for tax policy and administration, OECD
“Regimes that provide for a tax preference on income relating to intangible property raise the base-eroding concerns that are the focus of the FHTP’s work. At the same time, it is recognised that IP-intensive industries are a key driver of growth and employment and that countries are free to provide tax incentives for R&D activities, provided that they are granted according to the principles agreed by the FHTP.”

38. The agreed principles that are mentioned above may have serious consequences for patent box regimes, where benefits are available without significant substance and activity. Irrespective of the exact outcome of the report and the way in which substantial activity is defined, some current patent box regimes may have to change to avoid being classed as harmful.

39. The harmful tax practices report also seeks to improve transparency in relation to preferential regimes, including compulsory spontaneous exchange on rulings related to such preferential regimes. The report suggests that this type of transparency will allow the home country to take any necessary defensive measures.

**Intellectual Property & Patent Boxes**

Intellectual property is a major driver in value creation for many multinational groups and hence the location of IP can be a very important factor underlying a multinational group’s effective tax rate. As discussed above, one of the key pillars of the OECD BEPS project is to try to align profit recognition and taxing rights with substance and for this reason it is likely that many MNEs may consider bringing IP currently located “offshore” in havens “onshore”.

IP location will often be driven by whether a location has, or has the potential to have, sufficient substance to own, manage and exploit the IP and also whether the location offers a favourable taxation regime for income related to that IP. Hence, in a competitive taxation environment many jurisdictions are looking to set themselves apart as a location of choice for IP centralisation.

**Patent Boxes**

A Patent Box (sometimes referred to as an Innovation Box, or Intellectual Property regime) is a special tax regime which provides for the application of an effective tax rate (by exemption of a substantial part of the tax base) which is lower than a country’s standard corporation tax rate, to certain profits derived from Intellectual Property. There are variations on how such regimes are designed.

There has been some media attention focused on the EU Code of Conduct Group on Business Taxation in recent months as it has been examining the issue of a number of patent box regimes in operation in EU member states.

The Code of Conduct Group was established in 1998 to combat harmful tax competition in corporate taxation. The Code is not a legally binding instrument but it does have political force. By adopting the Code, the Member States have undertaken to 1) roll back existing tax measures that constitute harmful tax competition, and 2) refrain from introducing any such measures in the future.

The issue of patent boxes is also being examined by the European Commission in relation to potential State Aid.
Action 8: Assure that transfer pricing outcomes are in line with value creation: intangibles

40. At the outset of the BEPS project it was decided that Actions 8/9/10 would be dealt with independently and that an interim report relating to Action 8, intangibles, would be provided in 2014. However, it became apparent at an early stage that these three actions would need to be dealt with in parallel on account of their interlinking nature. Due to this, large portions of the transfer pricing report on intangibles are not agreed.

41. These three transfer pricing actions drill to the heart of one of the objectives of the BEPS project; to align substance with taxing rights. The current transfer pricing guidelines rely on the arm’s length principle which, itself, seeks to match substance with taxing rights. The work being undertaken by working party 6 is seeking to make certain amendments to sections of the transfer pricing guidelines in order to ensure that these guidelines keep pace with changing business models and the rapid evolution of global economics.

42. Significant progress has been made in addressing the concern raised by the separation of the location of profits from intangible property and the location of real economic activity and value creation. Work in this area should herald an end to “cash box” companies and this has been stated by the OECD;

“...significant progress has been made in addressing the serious concern raised by the separation of the location of the return on intangible property and the location where economic activities take place and value is created. There is consensus that artificial shifting of profit to no or low tax environments jurisdictions (such as through “cash boxes”) can no longer be tolerated. Draft guidance has been developed for intangibles. However, it is also recognised that the 2015 work relating to the transfer pricing treatment of risk and capital and relating to the special measures that may be considered in this area, will influence the final outcomes of the work on intangibles.”

43. Hence, while work on the transfer pricing guidelines is not yet complete, it is clear that the near future will bring significant change for many tax structures currently used by multinational companies.

44. The work in this area centres on amendments to Chapter VI of the Transfer Pricing Guidelines. Chapter VI deals with intangibles and has four distinct sections:

A. Identifying Intangibles
B. Ownership of Intangibles and Transactions Involving the Development, Enhancement, Maintenance, Protection and Exploitation of Intangibles.
C. Transactions involving the use or transfer of intangibles
D. Supplemental Guidance for determining Arm’s Length Conditions in Cases Involving Intangibles

45. There has been agreement in relation to Section A which updates chapter VI of the Transfer Pricing Guidelines to reflect current business models. Similarly there has been general agreement in relation to Sections C & D which deal with transactions involving the use or transfer of intangibles and supplemental guidance on the arm’s length rule respectively. Some areas of Section D still need to be

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14. “Final and intermediate guidance on transfer pricing aspects of intangibles”, Centre for Tax Policy and Administration, OECD - (shaded sections of this report are not agreed upon by the member states)
15. “Explanatory statement on the 2014 BEPS deliverables”, Centre for Tax Policy and Administration, OECD
finalised as some of this section is subject to the work that will be undertaken in 2015 under Actions 8 and 9.

46. It is, however, section B which could have the most significant impact on inter group trade and the use of intangibles. This section is all marked as an interim draft and will be considered further as part of the 2015 work of WP6. The main issues of concern centre on the return to be awarded to the legal owner. If the legal owner performs all “important functions” commonly referred to as DEMPE functions (Development, Enhancement, Maintenance, Protection and Exploitation); provides all assets, including funding; and bears and controls all of the risks; then they will be entitled to all of the anticipated returns from the exploitation of the intangible. To express this another way, if a legal owner only funds, but does not perform the DEMPE functions, it may only be entitled to a risk-adjusted funding return. While a significant amount of work has been undertaken on section B it is not possible to finalise it until work on Action 8 and 9 has been completed.

47. The above is summarised in the following extract from the report and highlights the potential changes which may impact existing tax structures;

“If the legal owner of an intangible in substance:

- Performs and controls all of the functions . . . related to the development, enhancement, maintenance, protection and exploitation of the intangible;
- Provides all assets, including funding, necessary to the development, enhancement, maintenance, protection, and exploitation of the intangibles; and
- Bears and controls all of the risks related to the development, enhancement, maintenance, protection, and exploitation of the intangible,

then it will be entitled to all of the anticipated, ex ante, returns derived from the MNE group’s exploitation of the intangible. To the extent that one or more members of the MNE group other than the legal owner performs functions, uses assets, or assumes risks related to the development, enhancement, maintenance, protection, and exploitation of the intangible, such associated enterprises must share in the anticipated returns derived from exploitation of the intangible by receiving arm’s length compensation for their functions, assets and risks. This compensation may, depending on the facts and circumstances, constitute all or a substantial part of the return anticipated to be derived from the exploitation of the intangible.”

EU Joint Transfer Pricing Forum (JTPF)16

The JTPF works within the framework of the OECD Transfer Pricing Guidelines and operates on the basis of consensus to propose to the Commission pragmatic, non-legislative solutions to practical problems posed by transfer pricing practices in the EU.

The work of the JTPF is divided into 2 main areas:

1) the Arbitration Convention (AC) - a specific dispute resolution mechanism for transfer pricing cases;

2) other transfer pricing issues identified by the JTPF and included in its work programme.

Action 13: Re-examine transfer pricing documentation.

48. The Master file, local file and country by country reporting template will require taxpayers to articulate consistent transfer pricing positions, will provide tax administrations with useful information to assess transfer pricing risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries. This information should make it easier for tax administrations to identify whether companies have engaged in transfer pricing and other practices that have the effect of artificially shifting substantial amounts of income into tax-advantaged environments.

49. The report details the contents of the proposed master and local files. Briefly, the “master file” would contain high level global information regarding a group’s global business operations and transfer pricing policies—the file would be available to all relevant country tax administrations. The “local file” would contain more transactional transfer pricing documentation such as the number and value of related party transactions.

50. The CbC report requires aggregate information, set out jurisdiction-by-jurisdiction, relating to the global allocation of the income, the taxes paid, and certain indicators of the location of economic activity for each tax jurisdictions in which the MNE group operates.

51. As some nations had sought more information which they believe would be necessary for risk assessments, it was agreed that the information to be included in the various files would be reviewed again no later than the end of 2020.

Global efforts to improve tax information exchange

FATCA

‘FATCA’ refers to the Foreign Account Tax Compliance Act, which is US legislation that requires Financial Institutions outside the US, who carry on business in or with US Financial Institutions, to report to the US tax authorities (IRS) in respect of financial accounts held with them by US persons.

Direct reporting by foreign financial institutions to the IRS would result in a significant administrative burden for such companies and would also result in data protection issues. As a result, a number of countries have decided to enter bilateral agreements with the US to enable the exchange of such information. Ireland was the 4th country in the world to conclude such an agreement. The agreement provides that Irish financial institutions will report to the Irish Revenue Commissioners in respect of US account-holders and, in exchange, US financial institutions will be required to report to the US Internal Revenue Service in respect of any Irish-resident account-holders. The two tax authorities will then automatically exchange this information on an annual basis. The main purpose of such agreements is to combat international tax evasion, by preventing individuals from hiding money outside of either State in order to avoid paying tax.

DAC – The EU’s response to information exchange

During the 2013 Irish EU Presidency the G20 and G8 championed the global automatic exchange of information as an important tool to combat tax avoidance and evasion. Responding very quickly to a request from the May 2013 European Council the Commission presented a proposal to revise the
existing EU Directive on the exchange of information — the Directive on Administrative Cooperation (DAC). There are however concerns among many Member States that there are three standards of automatic exchange of information (AEOI) – US FATCA, EU AEOI and the OECD Global Standard. Of the three standards the EU AEOI is the longest-standing having been in place since 2004.

The OECD, building on its G20 and G8 mandate has finalised a Common Reporting Standard – CRS. This standard is expected to be adopted by EU Member States via the proposal which is known as DAC 2.

The OECD’s Global Forum on transparency and exchange of information on tax matters

The Global Forum brings together 120+ countries and jurisdictions for wide-ranging discussions on tax transparency and exchange of information. Its sixth meeting in October 2013 attracted more than 200 delegates from 86 member jurisdictions and 11 international organisations. During the Jakarta meeting, six new countries became members: Azerbaijan, Dominican Republic, Lesotho, Romania, Senegal and Ukraine.

Working through a peer review process, the Forum assesses the adequacy of its members’ legal and regulatory framework for exchange of information in tax matters (Phase 1 review) as well as the application of this framework (Phase 2 review). To date, 124 peer reviews have been completed, including 50 Phase 2 reviews. Ireland is one of those 50 countries. The results of this comprehensive analysis of how countries exchange tax information with each other, confirm that Ireland meets the highest international standards. The report confirms, following a forensic peer review, that the Irish system for the exchange of tax information is as good as anywhere in the world, and better than most.

Action 15: Develop a multilateral instrument (feasibility)

52. It is widely held that for the BEPS project to succeed it is necessary for all countries to agree on an approach and to adopt measures on a multilateral basis. The reasons for coordinated action were summed up by Pascal Saint Amans in his testimony to the US Senate Committee on Finance:

“Uncoordinated, unilateral action by individual countries to exert taxing rights over cross-border activity would only make the problem worse, resulting in double or multiple taxation, increasing disputes for business and among governments, and harming economic growth.”

53. Changes to the model tax treaty can take time and even in cases where there is consensus it can take a substantial amount of time and resources to implement these changes into most bilateral tax treaties. As such, there would be concern that the implementation/adaptation of the measures developed by the BEPS process could be a drawn out and potentially fractious process. Due to these concerns it was felt that there was a need for all parties to be able to act in concert on changes and hence the potential implementation of a multi-lateral instrument.

54. A multilateral instrument (or convention) is one which can be adopted multilaterally by all the countries (who sign-up) and will therefore act as a way of implementing the treaty related changes from BEPS without having to go through the treaty-by-treaty route which could be very time consuming.

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17 Testimony of Pascal Saint-Amans Director, Centre for Tax Policy and Administration (OECD), before the United States Senate Committee on Finance on July 22, 2014.
55. The report on Action 15\textsuperscript{18} was developed by the OECD secretariat in consultation with experts on international public law and international taxation to determine whether the adoption of such an instrument would be feasible.

56. The main finding of this report on the multilateral instrument is that a multilateral instrument is both desirable and feasible suggesting that \textit{“the benefits are numerous, while burdens can be addressed or avoided”}. The report goes on to outline why this is the case.

57. Furthermore the report highlights that there is precedent for such an instrument and provides the following example of “a recent success story” in the form of the OECD’s Convention on Mutual Administrative Assistance in Tax Matters.

\begin{quote}
A recent success story: the Convention on Mutual Administrative Assistance in Tax Matters\textsuperscript{19}

The Convention on Mutual Administrative Assistance in Tax Matters (“Convention”) was opened for signature by the member states of the Council of Europe and the OECD in 1988, entered into force in 1995, and had only 14 signatories as of 2009. At its April 2009 London Summit the G20 Leaders called on the OECD to modernise this instrument to align it to contemporary international standards on exchange of information, and to open it to all countries, by stating in the G20 Declaration on Strengthening the Financial System that they were “committed to developing proposals, by end 2009, to make it easier for developing countries to secure the benefits of a new cooperative tax environment”. A Protocol to the Convention was negotiated in 2009 and the amended Convention was presented at the annual OECD Ministerial meeting in May 2010, and the amended Convention and Protocol were opened for signature by a wide range of countries on 1st June 2011. The Convention – a single multilateral legal instrument – performs functions that would have otherwise required negotiating over 1800 new bilateral agreements. By means of the Convention, the G20 swiftly and successfully initiated a step change in transparency in cross-border tax matters globally.
\end{quote}

\textsuperscript{18} “Developing a multilateral instrument to modify bilateral tax treaties”, Centre for Tax Policy and Administration, OECD

\textsuperscript{19} “Developing a multilateral instrument to modify bilateral tax treaties”, Centre for Tax Policy and Administration, OECD
3. BEPS 2015 deliverables

58. This section sets out a high-level summary of the objectives of the 2015 BEPS actions which have still to be discussed and agreed by the member states.

**Action 3: Strengthen Controlled Foreign Corporation (CFC) Rules**

59. CFC rules generally operate to tax, at the level of the parent company, a portion of the income of controlled foreign subsidiaries as it arises, i.e. prior to the repatriation of that income by the payment of dividends or otherwise.

60. The area of CFC legislation is not one on which the OECD has previously focused. However due to the potential BEPS concerns associated with the possibility of creating affiliated non-resident entities to receive what might otherwise be income of a resident enterprise, the BEPS project will look at how CFC rules may serve as a deterrent to this type of activity.

61. In general CFC legislation only applies to passive income arising in foreign jurisdictions. In some cases a determining factor in relation to the application of the rules is the rate of tax applying to that foreign income; in other cases income arising to a subsidiary located in “listed” jurisdiction can be taxable in the parent location. There are numerous types of CFC legislation in force and hence the use of the term “CFC legislation” is used as a blanket term with wide coverage.

62. Some countries have already adopted CFC rules, some countries have no such rules and other countries have rules which have the same net effect as CFC rules. As was highlighted above, the design and application of existing CFC rules varies considerably and are necessarily country-specific. The work to take place in this area in 2015 will be relevant to both those countries with and those without some form of CFC legislation.

**Action 4: Limit base erosion via interest deductions and other financial payments**

63. There is general agreement that the use of interest and other financial payments as a means to obtain excessive deductions is an area which needs scrutiny under BEPS. Many countries, to a greater or lesser extent, have rules relating to the deductibility of interest and other financial payments. These range from thin capitalisation rules to targeted anti-abuse rules and, as with the CFC rules discussed above, are often country-specific and are often aligned with the overarching tax and economic policy of the jurisdiction.

64. The impact of any proposed rules would need to be considered in the context of industry specific concerns and especially those relating to the financial services industry. It would also be necessary to consider the rules in light of the ongoing work in relation to hybrids under Action 2.

**Action 5: Counter harmful tax practices more effectively, taking into account transparency and substance.**

65. Work on this area has been discussed above and will continue in 2015. Over the coming year the Forum on Harmful Tax Practices (FHTP) will complete its review of potentially harmful regimes and may also seek to engage with other non-OECD Member Countries to achieve a level playing field and
avoid the risk of the work on harmful tax practices displacing regimes from the OECD Member and Associate Countries to other countries, giving these other countries an unwarranted competitive advantage and therefore limiting the effectiveness of the whole exercise. The FHTP will also carry out further work on substantial activity and transparency.

**Action 7: Prevent the artificial avoidance of PE status**

66. The BEPS action plan states that “the definition of permanent establishment (PE) must be updated”, and it appears that, at present, there is general consensus that this is the case. The current definition does not take into account the changes in business models over the last 20 years. This means that, in many cases, a company can trade in a foreign jurisdiction without triggering a permanent establishment. That is not to say however that this, in certain circumstances, should not still be possible but, as with the rest of the BEPS actions, it will be necessary through the definition of a PE, to be able to drill down to the substance of a transaction and to determine whether there is artificial avoidance of a PE in a certain jurisdiction.

67. The potential of creating a “digital PE” or one based solely on the provision of services are areas that were looked at in detail by the Task Force on the Digital Economy – see action 1 – when they were dealing with the tax challenges of the digital economy. Liaising with Working Party 1, they will consider what progress, if any, the work on action 7 makes in this area during 2015 after which the Task Force will examine the options available in relation to these matters.

**Actions 8, 9 & 10: Transfer Pricing**

68. Work will continue on Action 8, as discussed above while actions 9 & 10 are not due to be finalised until the end of 2015. Initial discussions have commenced on these but the discussions are at a very early stage. These actions are intended to restrict or potentially deny a return being attributed to entities located in low tax jurisdictions who perform no or minimal activities, and specifically do not control or manage the associated risks.

**Action 11: Establish methodologies to collect and analyse data on BEPS and the actions to address it**

69. The BEPS report of 2013\(^{20}\) sought to demonstrate the need for the BEPS project in part by reference to several studies addressing the disconnect between the location in which value is created and the location of taxation. In order to determine the effectiveness of the results of the BEPS process it is necessary to develop methodologies to measure its success or failure and the specific areas of same. It will, however, be of the upmost importance in establishing these methodologies to ensure that they are both fair and representative and are appropriate methodologies for both small and large jurisdictions alike.

**Action 12: Require taxpayers to disclose their aggressive tax planning arrangements**

70. In order for jurisdictions to be able to identify risk areas and to act on such risks they need timely and comprehensive information in relation to tax planning techniques. For this reason some

\(^{20}\) “Addressing base erosion and profit shifting”, Centre for Tax Policy and Administration, OECD
countries (including Ireland) have enacted mandatory disclosure rules, which require the taxpayer, or tax advisers, to disclose information on specified types of tax planning structures.

71. The existing rules are country-specific and as such it will be interesting to see how the working party drafts the generic “best practice” proposals in this area.

**Action 14: Make dispute resolutions more effective**

72. Action 14 will seek to ensure “certainty and predictability for business” by improving the effectiveness of the mutual agreement procedure (MAP). Improvements in this area will be especially important due to the potential for elements of uncertainty arising from any new rules stemming from the BEPS project. The BEPS action plan notes that such uncertainty should be minimised where possible. Working Party 1 will address the problems that countries have which prevent them from solving treaty related disputes under the MAP. They will also give consideration to a mandatory and binding arbitration provision which could supplement the existing MAP provisions in tax treaties.

**Action 15: Develop a multilateral instrument**

73. Work on this area has been discussed above in relation to the interim report submitted to the G20 in September 2014. As the 2014 report concluded that such an approach is feasible the work in 2015 is expected to begin the development of such an instrument.
4. **BEPS in an EU context**

74. From an EU perspective, the implementation of any BEPS recommendations by EU member states will be dependent on their compliance with EU law. The fundamental freedoms in the Treaty on the Functioning of the European Union (TFEU), the direct tax directives, EU State aid rules and the decisions handed down by the Court of Justice of the European Union (CJEU) provide the framework within which the BEPS proposals will need to be constructed if EU member states are to be able to implement the recommendations without breaching EU law.

75. A detailed discussion of EU law is not warranted and as such the discussion below merely identifies a number of the actions that could potentially be impacted by EU law.

76. The proposed domestic rules outlined under Action 2 on hybrid mismatches could in principle violate the EU fundamental freedoms and CJEU case law.

77. Similarly the proposal set out by Action 6 on treaty abuse could also pose difficulties under a number of the different freedoms such as the free movement of capital and the freedom of establishment.

78. CFC rules that have been adopted by EU/EEA countries have come under consistent scrutiny from CJEU, especially in the landmark Cadbury Schweppes case, and hence it would be important, from an EU perspective, that the design of any potential recommendations stemming from Action 3 take account of any potential restrictions.

79. Action 7 of the BEPS project is focussed on permanent establishment. The interaction of any possible digital PE recommendation or other fundamental changes to the concept of PE, would need to be seriously considered.

80. It also seems clear that it will be desirable for the OECD’s Forum on Harmful Tax Practices, who under Action 5 are looking into preferential regimes such as patent boxes, to take account of the work that is being done by the EU’s Code of Conduct Group who are also examining the “substantial economic activity” criterion of patent box regimes.

81. As has been highlighted above there is still considerable work to be done by Working Party 6 in relation to changes to the transfer pricing guidelines. However, any potential changes which would seek to move away from the arm’s length principle would need careful consideration from an EU perspective.

82. These are just a few examples of where there is potential conflict between the desired outcomes of the BEPS project and the parameters imposed by EU law.

83. The European Commission takes part in the OECD discussions (without voting rights) and is cognisant of the potential issues mentioned above. It is the intention of the EU to work to try to address these concerns. It will be very important that solutions can be found and that compromises can be reached, as the alternative may result in a two-tier implementation of the BEPS proposals with the rules applying to EU/EEA members differing from those for third countries. It is hard to imagine how such a two-tier approach would work in practice as it is likely that this could lead to inequalities and potentially to further areas of mismatch.

84. Work on identifying appropriate solutions in this area, which could have a significant impact on the level of success of the BEPS project, is ongoing at both an OECD subgroup level and at wider EU commission meetings.
5. Results of the public consultation on BEPS

85. A public consultation was launched by the Minister for Finance in May 2014. 25 written submissions were received from a wide range of respondents. The Department of Finance would like to thank all those who made a submission.

86. The questions asked as part of the consultation process are repeated here for ease of reference.

The consultation questions

In responding to this consultation you are invited to:

- Give your views on the specific questions set out below. You don’t have to answer every question – you may choose to answer any or all of the questions.
- Provide details of any approaches or options you feel might be beneficial in dealing with the issues being addressed.
- Provide details of relevant issues not covered in this paper.
- Where appropriate, provide some analysis of the Exchequer cost/yield of your preferred option.
- Comment on the general direction in which you would like to see tax policy in this area develop.

Your views are important as they may help influence the taxation treatment and policy to be applied in the future.

Question 1:

Which of the international tax issues identified in the BEPS Action Plan would need to be considered the highest priorities for Ireland for examination with a view to action?

Question 2:

Are there other current international tax proposals that would be of concern to Ireland?

Question 3:

In a changing international environment, what’s the best way for Ireland to ensure that its taxation provisions, for example in relation to intangible assets, are competitive?

Question 4:

Are Ireland’s company residence rules appropriate in the context of BEPS and other international tax developments?

Question 5:

What are the critical considerations in shaping Ireland’s response to current international tax developments—either in general or with respect to particular issues?
Question 6:

Are there any other priority areas or future challenges that should be considered as part of this process?

87. A summary of the responses, on a question by question basis, has been provided below. Some of the respondents did not choose to answer all, or any, of the questions and in some instances there was overlap between the answers to the various questions. As such the summaries provided below are divided between the various questions to which they relate and not necessarily in line with the way they were provided in the submissions.

Question 1: Which of the international tax issues identified in the BEPS Action Plan would need to be considered the highest priorities for Ireland for examination with a view to action?

88. The responses to this question highlighted a broad range of the 15 actions which should be considered highest priorities for Ireland.

89. In relation to Action 1 (Digital Economy) a number of respondents agreed with the conclusions of the draft report on the digital economy which states that there should be no special tax provisions for the digital economy as the economy as a whole is becoming digitalised. There was also general agreement that the premise of a digital PE or a PE based on services should be resisted as it is not an appropriate solution and could lead to significant uncertainty.

90. A number of the responses highlighted the importance of Action 2 (Hybrids) and the potential issues that could accompany the draft proposals. The majority of the concerns raised by the respondents, in relation to hybrids, centred on the impact of the proposed rules on financial services companies (FS) which operate in a highly regulated industry sector. In certain cases FS companies are required to use hybrids, for example in certain circumstances additional tier one capital is introduced via hybrid instruments, and the proposed rules could have unintentional consequences on this industry sector. There were also calls in a number of the submissions that the percentage included in the related party definition should be increased to 50%. It is suggested that a lesser percentage could be very difficult for the FS industry to manage as often the investors in products are unknown. Respondents also pointed to the interaction of Actions 2 and 4 (Interest deductions) and that it would be necessary to wait to see the outcomes of Action 4 before any legislative changes on hybrids are enacted.

91. Those submissions which highlighted Action 3 (CFC) as a priority area in general noted that any proposal to introduce such rules must be looked at in a broader light and it would be important to ensure that the proposal was in line with Ireland’s strategic objectives. It was also noted that if such rules were introduced it may facilitate the introduction of a participation exemption for dividends. One respondent questioned whether it would really be necessary for Ireland to introduce such rules as the current legislations has many of the hall marks of a CFC regime. Finally, one submission noted that the introduction of CFC rules could lead to Irish companies questioning the attractiveness of Ireland as a long term holding location.

92. Many of the submissions highlighted Action 6 (treaty abuse) as a priority area for Irish business. There is general concern that the LoB article, as currently drafted, could lead to a reduction in access to treaties for some companies (especially in the FS space). This is very significant in relation
to the ownership provisions as they appear to discriminate against small countries. On this point there is agreement from the respondents that at a minimum, a derivative benefits clause would need to be included. Many respondents were of the view that a main purpose test could create significant uncertainty for tax payers which would reduce Ireland’s competitiveness as an attractive holding location. It was mainly in the context of treaty abuse that respondents advised caution in relation to any proposals under Action 15 (Multilateral instrument) as this instrument should not erode current treaty access. One submission suggested, in order to allow for a period of adjustment, that treaty changes should not be made via a multilateral instrument and that instead they should be amended as and when renegotiations take place. The interplay between EU law and the treaty abuse proposals were also highlighted.

93. A number of the respondents signalled that any changes to the transfer pricing guidelines due to Actions 8 (Intangibles), 9 (Risks & Capital) & 10 (High risk transactions) would need to be closely monitored. Some of the responses stressed that Ireland should resist any move away from the arm’s length standard towards any type of formula apportionment. One respondent did however suggest that Ireland should back the CCCTB proposals that are currently being discussed at the EU level. Another submission stated that any changes to the guidelines should be aligned with current business models used by Irish companies. In relation specifically to Action 9, two separate submissions suggested that proposals in relation to risk could have a serious impact on the FS sector as risk is a key concept in this world.

94. The area of transparency was highlighted as another key area for Ireland in the future. A number of submissions suggested that Ireland should go further in relation to information gathering/exchange by compelling multinational companies to disclose more information in relation to their operations, revenues and taxes paid. However a large number of the submissions suggested that the proposals of Action 13 (TP documentation/CbC reporting) should be framed with consideration to the cost of compliance for taxpayers, tax payer confidentiality and data protection. One submission suggested that the proposals outlined in the discussion draft report on Action 13 go far beyond the stated objectives. Another submission makes the suggestion that any such rules should not apply to SMEs due to the potentially significant compliance burden. In relation to the FS industry it was suggested that their already onerous reporting requirements (due to regulation etc) should be taken into account. A number of submissions suggested that Ireland should undertake a general review of its exchange of information clauses in its network of treaties. It is suggested that this review should have a broad scope which includes examining the feasibility, in practice, of information being exchanged. These submissions further suggested that an information exchange clause which is not practical is useless.

95. In relation to transparency, one respondent called for Ireland to introduce mandatory disclosure rules as suggested by Action 13 of the BEPS project. [It should be noted for clarity that Ireland already introduced these rules – in Finance Act 2010 – and they are contained in Chapter 3 of Part 32 of the Taxes Consolidation Act, 1997.]

**Question 2: Are there other current international tax proposals that would be of concern to Ireland?**

96. A number of the submissions outlined that there are currently a number of different reporting requirements in place, especially for companies operating in the financial services industry. There is concern that the various reporting proposals are not well-aligned and that when the BEPS proposals
are included that the burden on the tax payer is too large. It was also suggested that the definition of “financial account” in the common reporting standard should include an exemption for securities regularly traded on an established securities market. A similar exemption is provided for in FATCA and it is suggested that the lack of such could lead to serious compliance problems for Irish debt capital market issuers.

97. CCCTB was mentioned by some of the respondents with differing views in relation to its impact on Ireland. One submissions suggested that the introduction of such a regime could help to solve many of the BEPS problems and that if Ireland could increase its competitiveness it could seek to attract more substance which would in turn help with the profit apportionment. However this submission did also concede that the destination of sales principle within CCCTB would not favour Ireland. A number of other submissions were of the view that Ireland should resist any form of formula apportionment regime and that Ireland should continue its support of the arm’s length principle.

98. The increasing competitiveness of tax regimes in other jurisdictions was an area of concern highlighted by a number of the submissions. In this context it was suggested that Ireland should try to enhance its taxation offering. The enhancements made by the UK to their regime were offered by two submissions as an example of current competition. Another area of concern in relation to other jurisdictions was the potential for unilateral action (i.e. defensive measures) taken by such jurisdictions and the potential impact on Ireland of any such measures.

99. Two submissions highlighted the potential reputational impact that the current State aid investigation could have on Ireland.

100. The impact of tax regimes and the BEPS process on developing countries was raised by three respondents. One submission stated that the spillover from Ireland’s tax regime to that of developing nations would be very small and therefore Ireland should not dwell upon it. However two other submissions stress the importance of considering the impact of the international tax environment on the global south with one of the submissions suggesting that developing nations be included in the BEPS project. This submission also states that the impact of Ireland’s tax regime on developing countries should be considered. [It should be noted that the Department of Finance is currently undertaking a spillover analysis study and held a public consultation earlier this year in relation to same.]

101. Other areas that were mentioned in the submissions were the lack of advancement on TRACE, the EU financial transactions tax and its future, EU VAT proposals in relation to outsourced services, patent boxes and US tax reform/inversion activity. These areas were all mentioned as areas of concern.

**Question 3: In a changing international environment, what’s the best way for Ireland to ensure that its taxation provisions, for example in relation to intangible assets, are competitive?**

102. Some of the answers provided in the submissions which addressed this question were quite detailed, especially in relation to potential legislative changes. The general recommendations and ideas are set out below.

103. As the BEPS process is seeking to better align profits with taxing rights there was general agreement in the submissions that changes are needed to both the income tax regime and the SARP regime to ensure that companies located in Ireland can try to attract and retain the key decision
makers. A number of submissions stated that our current marginal rate is one of the highest in the EU while the entry level to that rate is one of the lowest in the EU. There were calls to both reduce the rate to below 50% and to increase the entry point. It was also suggested that the imposition of PRSI and USC on employee share schemes make these forms of remuneration less attractive and therefore make it difficult to incentivise employee retention.

104. In relation to SARP a number of suggested changes were highlighted in the submissions, however these were all also covered in the submissions to the public consultation on the SARP regime earlier this year and as such are not outlined here.

105. There was acknowledgement of the changes made to the R&D regime in light of the public consultation in 2013. However there were also calls for further enhancements to the regime. The item which appeared most frequently was a call for increased clarity for the taxpayer based on the view that there is significant administrative uncertainty at present. There were also calls for a reduction in the 4-year audit period as it was argued that this would lead to more certainty. In relation to the rules themselves, there were various views offered on the base year. Some submissions suggested that the base year be abolished or that at a minimum a timeframe for when it would be phased out should be provided. One submission suggested that the base year should be excluded for new projects that were not being undertaken in 2003. The other item that a number of submissions suggested was that the scheme should be more open to the use of agency/contract staff and that it should not be so in-house focused as this would more correctly align with modern global R&D business models. Finally in relation to the R&D credit it was suggested by a number of submissions that Ireland should seek to keep pace with competitor nations.

106. Another area which received a substantial focus in the submissions was in the area of intellectual property. A number of the submissions called for the introduction of a patent box but generally acknowledged that this would not be possible until there was more certainty from both the EU and the OECD in relation to an allowable design of such an income-based regime. On this basis a number of the submissions proceeded to make suggestions for changes to the current relief for capital expenditure on acquiring intangible assets contained in Section 291A. One of the more common suggestions offered was to expand the definition of qualifying intangible asset. It was also suggested in two submissions that it should be possible to re-value the IP at regular intervals so that account could be taken for internally generated IP and this would also serve to provide a longer life for the relief. It was also suggested that changes should be made so that the benefit could be more easily reflected in the company’s accounts. One such suggestion was to change the claw back provisions or to abolish them altogether. However another submission did suggest that the accounting issues posed would be difficult to solve unless there was a move to an income based regime. Finally one submission suggested that further guidance on the attributes needed to be considered as carrying on a trade in relation to IP be provided in order to give greater certainty to the taxpayer.

107. Three separate submissions suggested that Ireland could consider introducing a notional interest deduction (NID) regime. They noted such regimes have been introduced in a number of jurisdictions and commented that they can be an attractive tax offering for finance companies. They suggested that such a regime could significantly enhance the already attractive taxation offering for finance vehicles.

108. A number of the submissions stated that a change in the treatment of travel expenses for foreign directors who sit on boards of Irish companies was necessary. Currently these amounts are taxed in the hands of the director and it is suggested that this practice can hinder Irish companies from being able to attract the best international people to their boards.
A number of submissions suggested changes to the double taxation relief rules. In relation to royalties it was suggested that the current rules can hinder groups which have IP located in Ireland as there is no carry forward or pooling mechanism available, the submissions call for the inclusion of both. It is also suggested that the calculation of the Irish measure of the foreign income is too complex and can often lead to unrelieved foreign tax, as such it is recommended that this is changed to a more simple approach. In relation to dividends a number of the submissions call for the adoption of a full participation exemption but in general there is preference for the current system if the adoption of CFC rules was a “quid pro quo” for the introduction of the exemption.

A number of submissions called for extra resources to be given to the Revenue authorities. These extra resources should go to bolster the areas of transfer pricing and competent authority as it is agreed that Ireland will need to be strong in these areas going forward and in negotiations with other nations. It was also suggested that, to help attract mobile executives and decisions makers, Revenue could establish a mobile talent unit, similar to the Expatriate Team run by HMRC.

Many of the submissions have called on Ireland to continue to expand its tax treaty network and to especially focus on areas where we do not currently have many treaties in place such as Africa and South America.

The 12.5% rate is recognised as a key pillar of the Irish taxation offering and two suggestions were made in relation to an extension of this rate. One submission suggested that the rate should be extended to patent income of innovators, to try to support the growth of innovation and another submission suggested that the rate should be extended to passive income of corporate entities.

In relation to entrepreneurs one submissions suggested that Ireland introduce an entrepreneur’s relief similar to that on offer in the UK but with certain enhancements.

One submission suggested that the foreign earnings deduction should be improved by expanding the number of countries that it applies to and also reducing the number of days necessary in order to apply for the deduction.

**Question 4: Are Ireland’s company residence rules appropriate in the context of BEPS and other international tax developments?**

A number of the respondents commented specifically on the question relating to a possible change to the company residence rules.

Relatively few submissions were either outright in favour of or against change now, and it was notable that a number of the submissions that are against change in 2014 are still amenable to change if done so as part of the BEPS process. There was a clear message of change only when necessary.

A number of submissions made the connection between:

a. making a change (when necessary),
b. the need for ‘grandfathering’, and
c. the need for Ireland to stay competitive - in particular they called for introduction of a patent box (see above).
118. This message was also borne out in a number of stakeholder meetings the Department conducted with interested parties as part of the consultation process.

119. The submissions which argued against a change to the residence rules being made at this stage in general have a proviso that if changes were to be made by Ireland that a grandfathering period would be vital. In terms of the submissions which specify a recommended grandfathering period, the proposed period of grandfathering ranged from 5 to 7 years.

**Question 5: What are the critical considerations in shaping Ireland’s response to current international tax developments—either in general or with respect to particular issues?**

120. A number of submissions suggested that the key considerations in shaping Ireland’s response should be consistency and clarity. Taxpayers are in favour of open tax systems where any changes are made gradually and consistently and where the reasons for such changes are known, this would include Ireland weighing up the pros and cons of being a first mover on some of the BEPS proposals. It was also suggested that the Irish authorities should be strong in their defence of our tax system and should highlight changes that have already been introduced over the last number of years. One submission suggested that it may be necessary to increase resources for the BEPS project while another suggested that the area of dispute resolution was key to providing certainty to tax payers.

121. Some of the respondents listed some of the items discussed above in relation to the various BEPS actions and in relation to Ireland’s current tax regime. These included the view that the proposed LoB provisions could have a negative impact on Ireland, that a virtual PE was not an appropriate response to the digital economy and that Action 4 of the BEPS process could be an opportunity for Ireland to make changes to some of its complex interest deductibility rules.

122. It was the view of a number of respondents that the Irish authorities should increase their level of engagement with industry. Also prior to the enactment of any legislation, especially in relation to BEPS, there should be industry engagement in advance.

123. A number of submissions suggested both as part of this question and other questions that the Irish TP rules should be changed so that the over-remuneration of Irish companies would also fall within the scope of the rules as such a measure would show Ireland’s commitment to take action against international tax avoidance.

124. Some of the submissions suggested that Ireland’s tax policy should take account of the developing nations in the Global South. One such submission suggests that Ireland’s system, through the use by multinationals of loopholes, impoverishes nations of the Global South. Another submission states that “tax dodging” costs the developing nations circa €870bn annually.

125. One industry group submission suggested that it is very important that the Irish tax system is flexible so that it can stay in line with regulatory changes as and when they happen.

126. One submission suggested that Ireland should introduce a minimum effective tax rate.
**Question 6: Are there any other priority areas or future challenges that should be considered as part of this process?**

127. There was a call by a number of the submissions for Ireland to introduce the financial transactions tax that has been proposed at an EU level. One submission suggested that the government’s failure to join with the other states who are introducing the tax was “grossly irresponsible”.

128. A number of the submissions suggested that the timeframe of the BEPS project was not achievable and that important decisions should not be rushed due to political timeframes.

129. Two submissions suggested that the OECD should clearly define a tax haven which would help stop the inappropriate use of the term. It was also suggested that Ireland should treat seriously the accusation that Ireland is a tax haven.

130. A number of the submissions stated that Ireland should consider the impact on developing nations, especially when it comes to treaty negotiations. In this regard it was also suggested that the differences between the OECD and UN model treaties be considered.

131. One submission mentioned a number of measures that should be considered to make Ireland more attractive. These included allowing Employee Share Ownership Plans to qualify as Save As You Earn schemes as these plans are the preferred method used by US multinationals who seek to provide their employees with share options. Another suggestion was that the exemption for the provision of temporary accommodation should be increased from 3 to 12 months. Further it was suggested that there should be an international school set up in Dublin, and that there should be better incentives for education up to PhD level.

132. It was suggested by one respondent that there should be some form of time limit in relation to the use of losses forward by the Irish banking sector.

133. One submission suggested that the Irish government look into further alternative ways of helping SMEs secure funding, such as the promotion of angel investors and that the current regimes such as EIIS should also be promoted to a great extent.

134. One submission suggested that a national strategy should be developed that seeks to deepen the pool of expertise available with professional and business management skills. This is a medium term initiative which should build upon and enhance the existing strengths of the Irish workforce.

135. One submission called for an expedited rulings/non-binding opinions process to be established which would help to bring certainty to the tax payer and may help Ireland attract groups who wish to bring their IP or operations to an “onshore” location.
A list of the respondents to the consultation process is provided below:

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<tr>
<th>Organisation / Name</th>
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<td>Robert Lynch</td>
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<td>Michail Panteris</td>
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<td>Sinn Fein</td>
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<td>Gerard O’Brien</td>
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<td>Tax Executives Institute Inc</td>
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<td>Clearing House Group</td>
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<td>Sheila Killian</td>
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<td>PWC Tax Director Network</td>
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6. Potential impact for Ireland

The OECD & BEPS

136. The outcomes of the OECD BEPS process could have impacts on Ireland in the short, medium and long term. However, that is not to say that this will be negative or that the impact of the OECD BEPS project will not be felt by every country both involved and outside the OECD BEPS process.

137. As a small country it is of key importance that the BEPS process is being undertaken at the level of the OECD. As outlined above, the advantage for Ireland of the discussions taking place at the OECD is that Ireland has a voice in the negotiations. The OECD offers a fair and level playing field for these discussions on international taxation, on which there are very often divergent views. It is for these reasons, among others, that Ireland supports the OECD as the most suitable body to carry out the BEPS project.

Why BEPS and what are the alternatives?

138. There is general consensus among policy makers that there is a need for multilateral action to counter aggressive tax planning. Indeed, it is worth considering what the likely alternatives to an effective BEPS process might be.

139. Without this process, due to economic, political and public pressures it is likely that more unilateral measures would be taken by certain jurisdictions (many jurisdictions have already taken unilateral action in certain areas). These could include a range of defensive measures which could negatively impact those against whom the measures were addressed. Such defensive measures could range from the unilateral withdrawal of tax treaties to the inclusion of individual countries on a CFC black list. On this basis it is fair to say that the alternative to BEPS for many countries could be uncoordinated and unrestrained unilateral action, which would be a most unwelcome alternative.

Unilateral Measures

Withdrawal of tax treaties

On 1 January 2014 Mongolia unilaterally withdrew its tax treaties with the Netherlands & Luxembourg due to Dutch/Lux laws that Mongolia perceived allowed MNEs to evade taxation in Mongolia. Further the Mongolian tax treaties with the United Arab Emirates and Kuwait are both terminated with effect from 1 January 2015 and 1 April 2015 respectively.

Limitations on tax deductions

In order to attempt to protect their tax base a number of countries have moved to restrict deductible payments where those payments are being made to a company located in a jurisdiction with a tax rate below a certain level.

These measures offer an insight into the extreme level of unilateral measures that can be adopted in the absence of multilateral agreement.

Impact of the Actions on Ireland

140. Prior to discussing the potential impact of the various actions it is important to again stress that the BEPS project as a whole, or via any of its individual actions, is not focussed on Ireland’s, or indeed any other jurisdiction’s, tax rate. The Irish 12.5% rate will not change and is not under discussion as part of the BEPS project.
141. The finalisation of the 2014 BEPS reports has given food for thought in relation to the impact that the recommendations stemming from these reports and the 2015 reports could have on Ireland and our tax regime.

142. In the area of transfer pricing, the actions which focus on value creation (actions 8, 9 & 10) are likely to result in changes internationally. As is mentioned above, it is clear that certain structures, with little substance, are in their winter and as such there are opportunities for Ireland to become a location of choice for groups who wish to bring their intangible assets onshore together with the relevant substance.

143. Ireland’s FDI policy has always centred on substance and as such Ireland is well positioned to compete in the global FDI market for any investment relocating as a result of the BEPS process.

144. Ireland supports the arm’s length principle and is fully engaged with the work being undertaken by working party 6 in relation to the TP actions, including the work to be conducted in 2015 in connection with special measures.

145. The main finding of the digital economy report that it is not possible to separate the digital economy from the economy as a whole, is welcomed by Ireland. This conclusion aligns with the principles of the Irish taxation regime, a fair, open and transparent regime offering similar terms to all industry groups. It should be noted however that the work of the Task Force on the Digital Economy is not complete as it was concluded that many of the broader BEPS challenges related to the digital economy would potentially be dealt with by other BEPS actions.

146. Hybrid instruments/entities are used for reasons, such as regulatory requirements or funding structures, other than the avoidance of tax or the exploitation of a mismatch. However in cases where such structures are used to gain a tax advantage Ireland supports the work undertaken under Action 2. Further work in this area is however necessary as it will be important that unintended consequences (for example in relation to regulatory requirements) are avoided. This work will be done through the commentary on the application of the proposed rules which will be finalised in 2015.

147. Ireland is not mentioned in the interim report on harmful tax practices (Action 5) and on that level there should not be an immediate impact on Ireland from this report. However the general outcomes and recommendations could have an impact on how the Irish tax regime is shaped in the medium term. A large portion of the final report is expected to focus on preferential IP regimes.

148. The proposals for action on treaty abuse need further work in relation to both what is to be included and also the wording of the specific model articles for inclusion. As currently worded the Limitation on Benefits clause could cause significant issues for small countries, including Ireland, if a “Derivative Benefits” clause was not included. On the other hand a Principal Purpose Test could cause uncertainty in relation to treaty access. The OECD have acknowledged these concerns and it has been agreed that further work is needed in 2015.

149. It is also the case that these anti-abuse provisions could have unintended consequences for some industry groups and it was for this reason that the OECD provided that collective investment

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21 A Limitation on Benefits clause contains a number of different tests which allow a company to qualify for benefits under the treaty. The tests are largely objective tests of qualifying residence status by virtue of ownership, or business substance that must be satisfied. For more information please see the commentary on Action 6 in Section 2 above.

22 The principal purpose test seeks to disallow the treaty benefits where one of the main purposes is securing a treaty benefit. For more information please see the commentary on Action 6 in Section 2 above.
vehicles could be dealt with under the measures outlined in the 2010 CIV report. The OECD have also acknowledged that further work is needed in relation to alternative investment vehicles to the extent that countries do not wish to deprive them of treaty benefits.\(^{23}\)

150. The potential adoption of CFC rules by all countries will need to be examined in 2015. Ireland operates a worldwide system of taxation and so while income of foreign subsidiaries is not taxed on a contemporaneous basis it is taxed once remitted. The adoption of CFC rules would need to be considered in the context of our current legislation.

151. At present it is not possible to determine the level of impact of any recommendations which may be proposed under Action 4 (Interest). However, as is the case in relation to treaty abuse, it will be important that these rules do not unduly impact on some industry groups. Advancements in this area will be of significant concern to financial services companies but also to all groups with significant amounts of inter group debt. On this basis we would urge those stake holders to engage with any potential upcoming OECD consultations on this, or any other action.

152. As the 2015 actions approach finalisation next year a very important consideration will be the interaction between the various actions. It is clear that some of the actions have significant overlap and as such a co-ordinated approach towards implementation will be of utmost importance. This is an area which is of concern for many tax payers and one which Ireland will be actively involved in at OECD level.

**Conclusion**

153. It can be seen from the discussion above that the BEPS process could bring about considerable changes in the world of international tax. The project is timely in that this multilateral approach should reduce the instances of potentially harmful unilateral action by individual countries.

154. The BEPS project is built upon two pillars which are to align profits with substance and to address double non-taxation. Each country’s tax rate is not open to discussion.

155. The actions dealing with changes to the transfer pricing guidelines are central to the attempts to align profits with taxing rights and these changes may bring an end to “cash box” tax structures. Such changes could provide significant opportunities for Ireland to become one of the locations of choice for multinationals who are looking to “onshore” certain operations or intellectual property.

156. It will be important, however, to ensure that the changes to the TP guidelines do not go beyond the fundamentals of the current principles. Ireland supports the use of the arm’s length principle and any moves away from this principle, in special circumstances, would need to be carefully considered with their impacts fully examined.

157. The outcomes of both the work performed in relation to the digital economy and hybrid mismatches were very positive and while further work is needed in both areas significant progress has been made on each action.

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\(^{23}\) Collective investment vehicles are used by the funds industry and are entities that allows investors to pool their money and invest the pooled funds, rather than buying securities directly as individuals. They are generally managed by fund managers. Some of the more common types of collective investment vehicle are unit trusts, investment companies, exchange traded funds and REITs. Alternative funds relates to any other type of fund. The premise of the tax treatment of collective investment is that the investment vehicle should be tax-neutral to ensure that investors do not suffer any more tax by investing through the pooled vehicle than they would if they invested directly.
158. Reforms relating to documentation and transparency are very important from both a risk analysis and reputational standpoint. There are concerns from tax payers in relation to their increased administrative burden and these concerns have been noted by the OECD. It is clear, however, that some form of alignment between tax/transfer pricing and regulatory reporting would be desirable.

159. Many of the 2015 actions could have an impact on Ireland. The concerns relating to both the potential adoption of CFC rules and to potential restrictions on interest deductions, have been noted. While Ireland does not operate a CFC regime, we do have rules which seek to tax profits once remitted to Ireland. Similarly Ireland has significant legislation relating to interest deductions and as such any further recommended changes would need to be brought about in line with other potential reforms.

160. Hence, while the BEPS project offers a lot of positives, there will also be challenges for Ireland. It is for this reason that the Department of Finance sought the views of stakeholders on the issues and will continue to participate in this form of dialogue as the project moves forward towards finalisation and implementation.
7. Glossary of terms

**BEPS** – Base Erosion and Profit Shifting.

**Base erosion** – when a company undertakes base erosion it is attempting to reduce its taxable income and thereby reduce the amount of tax it has to pay.

**Profit shifting** – the practice of profit shifting is to move profits from one jurisdiction to another. This is advantageous where the taxable profits are moved from a high tax jurisdiction to a low/no tax jurisdiction (because there is a saving due to the difference in tax rates).

**The BEPS project** – this is a project that is being undertaken by the OECD to target harmful international tax practices by multinational corporations. The main aims of the project are to eliminate instances of double non taxation – i.e. instances where income of a company is not taxed in any jurisdiction – and to bring about a greater alignment between taxing rights and real economic activity.

**15 actions** - the BEPS project is being undertaken through 15 different actions which span across a number of areas that provide opportunities for base erosion and profit shifting.

**Project deadline** – the deadline for some of the actions is September 2014 with the remaining actions to be finalised by the end of 2015. These are the deadlines for the various focus groups, looking at the different actions, to report back to the G20. The deadlines are not implementation deadlines.

**Implementation of the outcomes of the project** - it is proposed that some of the recommendations that come out of the report would be enacted by way of a “multilateral instrument”. This would effectively be an OECD convention that would be signed up to by all the countries involved in the BEPS project (which also includes non-OECD countries). One of the actions of the BEPS project is looking at the design of such a convention.

**Digital economy** – There is no clear definition of the digital economy but it is generally accepted as the activities of IT multinationals or corporations with a significant internet presence. One of the actions is looking at BEPS issues associated with the digital economy and the potential ways to address these issues. Due to the pervasive digitalisation of the economy it may not be possible to identify the digital economy as a clearly distinguished subset of the general economy.

**Transfer Pricing (TP)** – the price at which one company sells products to another company is known as the “transfer price”. Transfer pricing is the method of profit allocation between group entities. A number of the BEPS actions look at transfer pricing and how the current transfer pricing rules can be used to create BEPS opportunities.

**Permanent Establishment (PE)** – a PE represents a taxable presence of a company in a jurisdiction where it is not established. A PE of a company is akin to a branch. One of the BEPS actions is looking at the international rules (set down in tax treaties) in relation to what triggers a taxable presence in another jurisdiction.

**Controlled Foreign Corporation (CFC) rules** – CFC rules operate to tax certain profits of foreign subsidiaries where those subsidiaries are taxed at a rate lower than a certain prescribed level. One of the BEPS actions is looking at how the proper design of CFC rules may help to reduce the opportunities for BEPS.

**Hybrid mismatches** – Hybrid arrangements take advantage of a difference between the tax laws of two countries creating a mismatch between the two tax systems to the benefit of the taxpayer. One
of the most common forms of hybrid mismatch is when a loan from a company in country A to a company in country B is classed as debt in country B but equity in country A – this may result in a deduction for interest in country B with no corresponding taxable income in Country A.

**Multilateral instrument** - A multilateral instrument (or convention) is one which can be adopted multilaterally by many countries and will therefore act as a way of implementing the changes from BEPS without having to go through the bilateral treaty-by-treaty route which could be very time consuming.

**Arm’s Length Principle** - The arm’s length principle determines that all transactions between associated enterprises should be valued as if they had been carried out between independent enterprises, each acting in its own best interest.