



**BASE EROSION PROFIT SHARING INITIATIVE
THE IMPLICATIONS FOR THE BAHAMAS**

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Introduction

I have been asked to speak on the Base Erosion Profit Sharing of the OECD, or better known as BEPS. This is a new acronym that, similar to CRS and the harmful tax initiative program, is geared at a multilateral approach to the application of uniform tax rules and standards. Unlike the CRS and the harmful tax practices initiatives of the past, BEPS has a focus not necessarily on the private client, but on the multinational commercial organization.

In recent years, international tax avoidance by multinational corporations has been front-page news with the largest companies such as Amazon, Apple, Google, Microsoft, and Starbucks being the most notorious. Across Europe, Asia, and the United States, press exposés and high-profile legislative hearings concentrated public attention on aggressive international tax planning.

At times tax planning and creative cross border tax avoidance was attacked as being immoral and unethical, despite its legality. The BEPS project was created to combat the erosion of the corporate income tax base, to eliminate the cross border tax planning for multinational companies that us tax lawyers have long made a living at.

Where did BEPS come from?

The BEPS project is a global effort to address international tax avoidance launched by the G-20, the annual gathering of the leaders of the world's twenty largest economies. It has been said that the BEPS project is the most extensive attempt to change international tax norms since the 1920s.

In 2012, the G-20 broadened its interest in international tax affairs to encompass the taxation of multinational corporations when it identified base erosion and profit shifting as a threat to the G-20's their own fiscal stability in the midst of politically unpopular austerity.

The OECD subsequently produced its BEPS Action Plan in a specially created working group incorporating officials from all non-OECD G-20 countries. The G-20 then endorsed that action plan, simultaneously mandating that the OECD provide "regular reporting on the development of proposals and recommendations to tackle the 15 issues identified in the action plan."

In October 2015, the OECD presented the final reports of its 15-Action plan to tackle BEPS. In short, the package of BEPS measures has three broad objectives. It aims to improve the coherence of international tax rules (Actions 2–5), reinforce its focus on economic substance (Actions 6–10) and ensure a more transparent tax environment with an effective implementation (Actions 12–14).

The focus of the project is simple: it is meant to address features of the tax regimes of different countries that allow multinational corporations to shift income to low-tax or no-tax jurisdictions and expenses to high-tax jurisdictions, thereby eroding the corporate income tax base of higher-tax, often larger-market economies.

As of the beginning of January 2018, 110 jurisdictions in total have committed to the implementation of the BEPS outputs through either their original participation in the BEPS project or their membership in the Inclusive Framework on BEPS Implementation. During 2017, 18 jurisdictions joined the Inclusive Framework (IF) of BEPS, namely Bahamas, Barbados, Belize, Botswana, British Virgin Islands, Cayman Islands, Djibouti, Malaysia, Maldives, Montserrat, Oman, Qatar, Saint Kitts and Nevis, Thailand, Trinidad and Tobago,

Turks and Caicos Islands, Vietnam and Zambia.

15 Actions of the BEPS Package

The BEPS package provides 15 Actions that equip governments with the domestic and international instruments needed to tackle BEPS. The goal is for countries to have the tools to ensure that profits are taxed where economic activities generating the profits are performed and **where value is created**. These tools also give businesses greater certainty by reducing disputes over the application of international tax rules and standardising compliance requirements.

The OECD/G20 BEPS Project creates a single set of consensus-based international tax rules to protect tax bases while offering increased certainty and predictability to taxpayers. I will provide you with a high level summary of what the 15 Actions addresses. We will then highlight the minimum standards that the Bahamas has agreed to implement.

ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY

Action 1 addresses the tax challenges of the digital economy and identifies the main difficulties that the digital economy poses for the application of existing international tax rules. The Report outlines options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation.

NEUTRALISING THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS

Action 2 develops model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effects of hybrid instruments and entities (e.g. double non-taxation, double deduction, long-term deferral).

DESIGNING EFFECTIVE CONTROLLED FOREIGN COMPANY (CFC) RULES

Action 3 sets out recommendations to strengthen the rules for the taxation of controlled foreign corporations (CFC).

LIMITING BASE EROSION INVOLVING INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS

Action 4 outlines a common approach based on best practices for preventing 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.

COUNTERING HARMFUL TAX PRACTICES MORE EFFECTIVELY, TAKING INTO ACCOUNT TRANSPARENCY AND SUBSTANCE

Action 5 revamps the work on harmful tax practices with a focus on improving

transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for preferential regimes, such as IP regimes.

PREVENTING THE GRANTING OF TREATY BENEFITS INAPPROPRIATE CIRCUMSTANCES

Action 6 develops model treaty provisions and recommendations regarding the design of domestic rules to prevent treaty abuse.

PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS

Action 7 contains changes to the definition of permanent establishment to prevent its artificial circumvention, e.g. via the use of commissionaire structures (i.e. agency arrangements) and the likes.

ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION

Actions 8 – 10 contain transfer pricing guidance to assure that transfer pricing outcomes are in line with value creation in relation to intangibles, including hard-to-value ones, to risks and capital, and to other high-risk transactions.

MEASURING AND MONITORING BEPS

Action 11 establishes methodologies to collect and analyse data on BEPS and the actions to address it, develops recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluates the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

MANDATORY DISCLOSURE RULES

Action 12 contains recommendations regarding the design of mandatory disclosure rules for aggressive tax planning schemes, taking into consideration the administrative costs for tax administrations and business and drawing on experiences of the increasing number of countries that have such rules.

TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING

Action 13 contains revised guidance on transfer pricing documentation, including the template for country-by-country reporting, to enhance transparency while taking into consideration compliance costs.

MAKING DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE

Action 14 develops solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, via a minimum standard in this area as well as a

number of best practices. It also includes arbitration as an option for willing countries.

DEVELOPING A MULTILATERAL INSTRUMENT TO MODIFY BILATERAL TAX TREATIES

Action 15 provides an analysis of the legal issues related to the development of a multilateral instrument to enable countries to streamline the implementation of the BEPS treaty measures, as well as the mandate to carry out that work in 2016. As per the OECD/G20 mandate, the ad hoc Group that will complete the work under Action 15 has been established, with over 90 countries participating.

Minimum Standards

Actions 5, 6, 13 and 14 contain BEPS minimum standards and those which The Bahamas has agreed to implement. Each of these minimum standards is subject to peer review in order to ensure timely and accurate implementation and thus safeguard the level playing field.

Action 5

The focus of the final report on Action 5, *Countering Harmful Tax Practices More Effectively*, is mainly on two topics: (i) requiring substantial activity for preferential regimes through the use of a “nexus approach” in the context of intellectual property (IP) regimes; and (ii) improving transparency through a framework for the compulsory spontaneous exchange of information on certain rulings that could give rise to BEPS concerns.

The focus of this Action is partially on tax rulings for tax preferential regimes. This element would be less important in The Bahamas as we do not have a tax system where ruling requests on cross border multilateral institutions and their operations occur. The spontaneous exchange provisions are more relevant for The Bahamas. This requires The Bahamas having a domestic legal framework allowing spontaneous exchange of information and exchange of information on request. It also requires us to have international exchange of information instruments that:

1. Are in force and effect; and
2. Permit spontaneous exchange of information on the relevant tax rulings and the subsequent exchange of the relevant tax rulings on request.

Action 6

The report on Action 6, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances*, was released on 5 October 2015 to address treaty abuse. That report provides several recommendations regarding changes to tax treaty provisions together with proposed domestic law provisions to address the inappropriate granting of treaty benefits and other potential treaty abuse situations. The Bahamas has no current tax treaties as we have no universal system of income taxation.

However, Action 6 is a minimum standard, and going forward tax treaties of which The Bahamas is a part must have as an overriding theory to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax evasion or

avoidance, including through treaty shopping arrangements. Much of the determination of treaty benefit will be based upon where the principle purpose of the activity is located. A strong principle purpose clause would limit the ability to treaty shop in lower tax jurisdictions.

Action 13

The final report on Action 13, Transfer Pricing Documentation and Country-by-Country Reporting, sets out a three-tiered standardized approach to transfer pricing documentation. This is probably the most relevant of the minimum standards for The Bahamas.

The Report described a three-tiered standardised approach to transfer pricing documentation. This standard consists of (i) a master file containing standardized information relevant for all MNE group members; (ii) a local file referring specifically to material transactions of the local taxpayer; and (iii) a Country-by-Country Report containing certain information relating to the global allocation of the MNE group's income and taxes paid together with certain indicators of the location of economic activity within the MNE group (the "CbC Report"). The master file and local file elements of the new transfer pricing documentation standard be implemented through local country legislation or administrative procedures and that the master file and local file be filed directly with the tax administrations in each relevant jurisdiction as required by those administrations.

The CbC Report is the material implementation of Action 13 on transfer pricing. It is recommended that all MNE groups be required to file the CbC Report each year except for MNE groups with annual consolidated group revenue in the immediately preceding fiscal year of less than € 750 million or a near equivalent amount in domestic currency. It is thought this exemption will exclude approximately 85 to 90 percent of MNE groups from the requirement to file the CbC Report, but that the CbC Report will nevertheless be filed by MNE groups controlling approximately 90 percent of corporate revenues.

No special industry exemptions should be provided, no general exemption for investment funds should be provided, and no exemption for non-corporate entities or non-public corporate entities should be provided.

Jurisdictions should require in a timely manner CbC reporting from ultimate parent entities of MNE groups resident in their country and exchange this information on an automatic basis with the jurisdictions in which the MNE group operates.

Again, I emphasize that this is a reporting regime, not a regime that mandates that a jurisdiction, in our instance The Bahamas, implements a comprehensive transfer pricing regime or an income tax regime that would make a transfer pricing regime relevant.

Action 14

The final report on Action 14, Making Dispute Resolution Mechanisms More Effective, reflects the commitment of participating countries to implement substantial changes in their approach to dispute resolution. These measures are aimed at strengthening the effectiveness of the Mutual Agreement Procedure (MAP), minimizing uncertainty and preventing unintended double taxation by ensuring effective and timely resolution of disputes. The final report represents an agreement reached by the countries by way of developing a minimum standard on the resolution of treaty-related disputes.

The minimum standard is constituted by specific measures that jurisdictions will take to ensure that they resolve treaty-related disputes in a timely, effective and efficient manner and is complemented by a set of best practices. Jurisdictions should ensure that their tax treaties contain a provision which requires the competent authority of their jurisdiction to endeavour to resolve by mutual agreement any difficulties or doubts arising as to the interpretation or application of their tax treaties.

Impact on The Bahamas

As a historical private wealth and private client jurisdiction many of you might want to know what the fuss is about BEPS as many provisions may not apply, and those that do apply have to do with multinational enterprises, of which there are few in The Bahamas. In this vein you might be correct. However, as we all know the private client practice is under considerable pressure, our value proposition of financial privacy for our clients is all but eliminated. We must find a new value proposition.

Much discussion on this new value proposition focuses around having physical presence operations in our jurisdiction. Yes, this includes family offices and other elements of private client work and with the implementation of the Commercial Enterprises Bill and other policy initiatives to encourage “businesses” in The Bahamas, BEPS becomes very relevant. The transfer pricing disclosures become significantly relevant in this regard.

The new value proposition, the reset as this conference would proclaim, in my view is the broadening of our industry, the physical presence of business operations and their principles. The discussion on establishment of headquarters in The Bahamas, the disclosure requirements for multilateral enterprises operating from within The Bahamas becomes an important consideration for our proposed new value proposition. To best understand why the BEPS transfer pricing rules are important in this regard, one must understand the basic tenants of transfer pricing.

Transfer pricing essentially states that when there are agreements and transactions between related companies in a group, the arrangements should be arms length, and more on the taxation of the revenue should be in the particular jurisdiction where the value is created. Taxation correlates to value creation. This is when in the context of BEPS, and the reporting required, that we speak of substance over form. The more substance and value we can originate from within The Bahamas, the more legitimate an opportunity for multinational companies to base in The Bahamas as a low tax jurisdiction. Regardless of the reporting, the value creation is here and the structure is substantiated.

This is even more plausible in the context of service industries, and it is a natural fit as we are a services economy jurisdiction. In the services industry, especially fintech, IT, and other cutting edge industries, they are all services based. If we are able to attract the value components of these industries to The Bahamas, the programing in a fintech world, the advisory functions in a wealth planning world, the central family office of the shareholder of an international conglomerate, we now offer a legitimate opportunity for tax mitigation and real savings to these enterprises, while exponentially expanding our economic presence in a cross boarder environment. Once we focus on this as our new value proposition, our new rest, then initiatives such as BEPS, CRS, and any other acronym you want to think of become irrelevant. And we can do all of this without changing our tax structure, without having to implement a corporate income tax, a broader economy creates a broader tax base which increases revenue to the Government.

With the right policy decisions, the efficiencies of Government bureaucracies, making business easy in The Bahamas, and the right positioning, this is our value proposition, we do thrive and not merely survive in a transparent world.

Conclusion

International tax law has entered a new era of multilateralism. Over the last few years, in response to unprecedented political attention to international taxation, the G-20 and OECD acted as the primary agenda-setter for international tax diplomacy. Given the heightened political profile of international tax affairs, and the tendency for the G-20 and OECD to continue pursuing an issue once it begins to do so, there is no reason to believe that this phenomenon is temporary. Rather, we likely have a “new normal.” Our goal must not be to survive the new normal, but to define ourselves and do all that is necessary to cause The Bahamas to be the preferred international business center of the new normal.

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