Chapter 3. Implementation and impact of the BEPS package

This chapter concerns the implementation and impact of the package of BEPS measures released in October 2015. It focuses specifically on those BEPS Actions that are most relevant to digitalisation, and considers the impact of those measures to date in addressing BEPS concerns, as well as the broader tax challenges that go beyond BEPS that were identified in the 2015 BEPS Action 1 Report.

3.1. Overview

252. This chapter describes the current progress in the implementation of the measures outlined in the base erosion and profit shifting (BEPS) package, with a particular focus on the measures relevant to digitalisation and their impact on the behaviour of highly digitalised businesses. These relevant measures include the direct tax measures developed under Action 7 (prevent the artificial avoidance of permanent establishment (PE) status), Actions 8-10 (assure that transfer pricing outcomes are in line with value creation), Action 3 (strengthen Controlled Foreign Company (CFC) rules), Action 5 (tackle harmful tax practices) and Action 6 (prevent treaty abuse). They include also the new guidelines and implementation mechanisms relating to Value Added Tax (VAT) that were agreed under Action 1 to level the playing field between domestic and foreign suppliers.

253. In the area of direct taxes, while it is still relatively early days, evidence is available that countries have gone a long way in achieving a widespread implementation of the various BEPS measures, and that this is already having an impact. While the adoption rate of the permanent establishment (PE) related provisions (Action 7) through the Multilateral Convention (MLI) is currently low, this does not reflect the full degree of implementation and impact of the MLI over time, as indicated by the early responses of some digitalised MNEs (e.g., Amazon, eBay, Facebook) that have already started changing their trade structures based on remote sales models to local reseller models. Equally important, a significant number of MNEs have already taken pro-active steps aimed at aligning their corporate structures with their real economic activity, either by reconsidering their transfer pricing positions and/or by relocating valuable assets, such as intangibles, in jurisdictions where substantial economic activities take place (i.e., so-called "on-shoring" of assets).

254. This early evidence of the impact and implementation of some key BEPS measures holds much promise for the resolution of double non-taxation concerns exacerbated by digitalisation. For example, the recent US tax reform includes the concerted implementation of strengthened CFC rules (Action 3) and anti-hybrid rules (Action 2), and similarly important reforms involving the treatment of CFCs and hybrid mismatch arrangements have taken place in Japan and in European Union (EU) Member States (through the EU Council's Anti-Tax Avoidance Directives).

255. At the same time, the relevance and impact of the BEPS measures that have been implemented are much less evident for the broader direct tax challenges raised by digitalisation (i.e., nexus, data, and characterisation). For a large number of countries, these challenges remain to a large extent unaddressed. This is because the relevant measures of the BEPS package were primarily designed to target instances of double non-taxation rather than the more systematic tax challenges posed by digitalisation.

256. In the area of indirect taxes, the success and impact of the BEPS implementation process is also evident. An overwhelming majority of OECD and G20 countries have adopted rules for the VAT treatment of business-to-consumer (B2C) supplies of services and intangibles by foreign suppliers in accordance with the OECD International VAT/GST Guidelines. Early data shows that this has led to significant additional revenue in the adopting countries. For example, the European Union (EU) has identified that the total VAT revenue declared via its simplified compliance regime in 2015 (the EU regime's first year of operation) was in excess of EUR 3 billion.

3.2. Introduction

257. The 2015 BEPS Action 1 Report concluded that digitalisation presents no unique BEPS issues. Nonetheless, some key features of highly digitalised business models can exacerbate BEPS concerns and additionally, create a number of broader tax challenges.[1] In direct taxation, the 2015 BEPS Action 1 Report described the broader challenges as relating to nexus, data, and characterisation. In the indirect tax context, they were described as relating to the collection of VAT[2] on cross-border transactions, particularly where goods, services and intangibles are acquired by private consumers from foreign suppliers.

258. At the time the 2015 BEPS Action 1 Report was adopted, there was a clear expectation that the consistent and widespread implementation of the BEPS package would substantially address many of the double non-taxation concerns raised by digitalisation. Specifically, the work on Action 3 (strengthen Controlled Foreign Company (CFC) rules), Action 7 (prevent the artificial avoidance of permanent establishment (PE) status) and Actions 8-10 (assure that transfer pricing outcomes are in line with value creation) was recognised as particularly important in tackling aspects of BEPS behaviour exacerbated by digitalisation.

259. Additionally, there was an expectation that the implementation of some recommendations of the BEPS package had the potential to affect the scope of the broader direct tax challenges related to nexus, data, and characterisation (OECD, 2015$_{[1]}$).[3] This is notably the case for the amendments to the PE definition under Action 7 (Sub-section 3.3.1), as well as the new guidelines and collection mechanisms related to VAT agreed under Action 1 (Sub-section 3.4).

260. As the implementation of the BEPS measures is still in its early stages, data on the impact of the measures remains limited. Therefore, a systematic assessment of the effect of the various BEPS measures will only be possible in the coming years when the full impact of the behavioural responses of taxpayers will begin to be reflected in the micro- and macro-level data and when new sources of data covering the post-BEPS period become available.[4]

261. In the area of VAT, however, evidence is already available that countries are implementing the principles recommended in the 2015 BEPS Action 1 Report on indirect taxation, which have now been enshrined in the OECD International VAT/GST Guidelines (OECD, 2017$_{[2]}$). Not only are these measures being adopted by a large number of countries, but they are already beginning to yield substantial additional tax revenues in the market jurisdiction, where these measures have been implemented.

262. There is also growing evidence that businesses are beginning to change the nature of their tax planning arrangements for corporate tax purposes in some countries and regions. For example, in some countries a number of global businesses supplying digital products and services have already altered their structures in respect of their cross-border sales (e.g. Amazon, E-bay, Facebook, Google).[5] They have moved towards the conclusion of sales contracts through local distribution activity in response to the measures developed under Action 7 (prevent the artificial avoidance of permanent establishment (PE) status), even though these measures have very recently begun to be introduced. While it had previously been the case that the OECD Transfer Pricing Guidelines had stipulated that taxation should occur in line with functions, assets and risks, the measures delivered under the BEPS Project provided more guidance and clarity in this regard, and already a number of MNEs involved in heavily digitalised activities

have proactively taken steps aimed at aligning their corporate structures with their real economic activity. This has notably been evidenced by relocating some valuable assets (such as intangibles) and risks from low-tax jurisdictions to other jurisdictions where substantial business activities take place (so-called “on-shoring” of assets).[6] These early responses to the implementation of some BEPS measures hold promise for the resolution of some double non-taxation concerns raised by digitalisation. Their relevance and impact are, however, much less evident for the broader direct tax challenges related to profit allocation and nexus, which in the view of many countries remain to a large extent unaddressed.

263. This chapter describes the current progress in the implementation of the BEPS package, with a particular focus on the measures relevant to digitalisation and their impact on the behaviour of highly digitalised businesses. The chapter is structured as follows. First, it briefly describes the implementation of the measures of the BEPS package that were identified as most relevant to the digitalisation of the economy. The chapter also provides a preliminary assessment of the impact of the relevant BEPS measures on tax structures commonly used by highly digitalised businesses and their effect on some aspects of the broader tax challenges arising from digitalisation.

3.3. Implementation of the BEPS package

264. A comprehensive description of the implementation of the various measures of the BEPS package, with a focus where relevant on the significance of these measures for digitalised businesses, is included in Annex 3.A. In contrast, this section will focus on describing the progress in the implementation of the measures of the BEPS package that were identified as particularly relevant in tackling BEPS behaviour exacerbated by digitalisation as well as the broader tax challenges of digitalisation. These include the actions taken to implement the direct tax measures developed under Action 7 (Prevent the artificial avoidance of permanent establishment (PE) status), Actions 8-10 (Assure that transfer pricing outcomes are in line with value creation) and Action 3 (Strengthen CFC rules). It also includes a description of the implementation of the new guidelines and implementation mechanisms relating to VAT that were agreed under Action 1 to level the playing field between domestic and foreign suppliers.

3.3.1. Implementation of the key direct taxation BEPS measures

265. The most relevant BEPS direct tax measures for highly digitalised businesses include changes to international standards – i.e., amendments to the PE definition in Article 5 of the OECD Model Tax Convention (Action 7) and revisions to the OECD Transfer Pricing Guidelines related to Article 9 of the OECD Model Tax Convention (Actions 8-10) – and a domestic tax measure – i.e., guidance based on best practices for jurisdictions intending to limit BEPS through CFC rules (Action 3). Other measures of the BEPS package are also considered as they are likely to impact highly digitalised businesses, such as the new standard on treaty abuse (Action 6) and the measures related to harmful tax practices (Action 5).

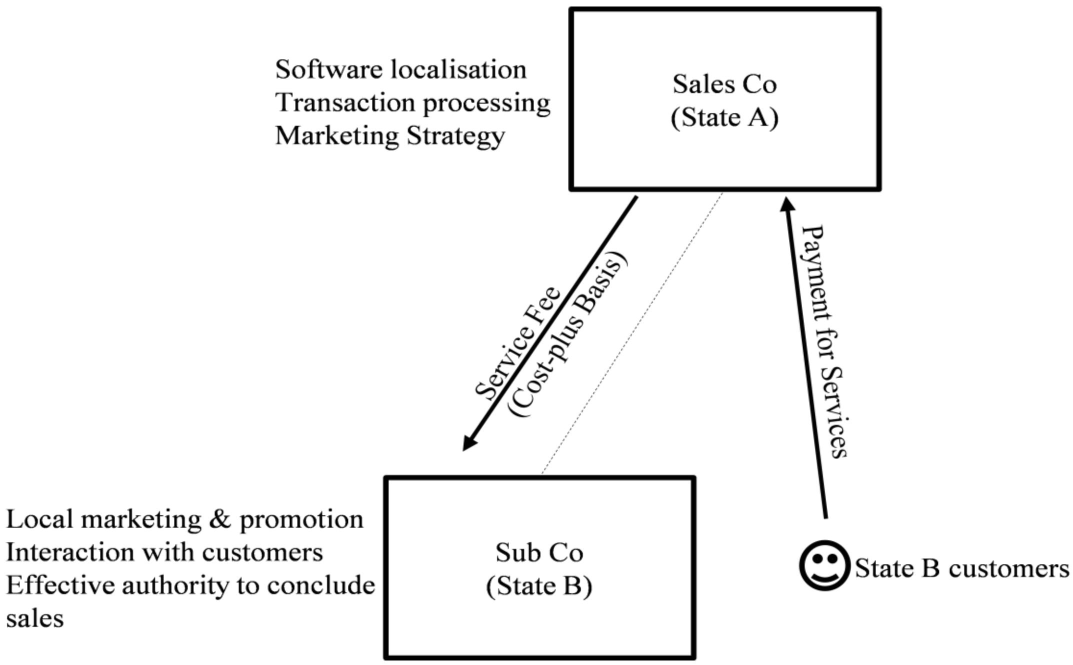
266. While most of these changes are not minimum standards, their implementation has particular relevance to highly digitalised businesses and it is expected to ensure a better alignment between the location of taxable profits and the underlying economic activity.

Preventing the artificial avoidance of permanent establishment status (Action 7)

267. The possibility to reach and interact with customers remotely through the Internet, together with the automation of some business functions have significantly reduced the need for local infrastructure and personnel to perform sales activities in a specific jurisdiction (i.e., scale without mass). The same factors create an incentive for MNEs to remotely serve customers in multiple market jurisdictions from a single, centralised hub. In certain cases, however, the MNE group continues to maintain a degree of presence in countries that are significant markets for its products, for instance by establishing a local subsidiary responsible for supporting and facilitating the sales (so-called "trade structures"). The latter is typically remunerated for the services it provides on a cost plus basis.

268. Figure 3.1 shows that these structures can present some BEPS concerns. This is the case when the functions allocated to the staff of the local subsidiary under contractual arrangements (e.g., technical support, marketing and promotion) do not correspond to the substantive functions performed. For example, the staff of the local subsidiary may carry out substantial negotiation with customers effectively leading to the conclusion of sales. Provided the local subsidiary is not formally involved in the sales of the particular products or services of the MNE group, these trade structures generally avoid the constitution of a dependent agent PE in the market jurisdiction.

Figure 3.1. Scenario involving the avoidance of permanent establishment status



269. In response to these BEPS risks, Action 7 resulted in the amendment of key provisions of Article 5 of the OECD Model Tax Convention and its Commentary. The changes aim to prevent the artificial avoidance of PE status which is the main treaty threshold below which the market jurisdiction is not entitled to tax the business income of a non-resident. In addition, the 2015 BEPS Action 1 Report noted that these changes could help mitigate some aspects of the broader direct tax challenges regarding nexus, if widely implemented. These expectations were primarily relevant for situations where

businesses have some degree of physical presence in a market (e.g., to ensure that core resources are placed as close as possible to customers) but would otherwise avoid the PE threshold.

270. More specifically, Action 7 provided for the amendment of the dependent agent PE definition through changes to Article 5(5) and 5(6) of the OECD Model Tax Convention. The amendments address the artificial use of *commissionnaire* structures[7] and offshore rubber stamping arrangements. Some structures common to all sectors of the economy involved replacing local subsidiaries traditionally acting as distributors with commissionaire arrangements. The result was a shift of profits out of a certain jurisdiction but without a substantive change in the functions performed there. Other structures more specific to highly digitalised businesses, such as the online provision of advertising services, involved contracts substantially negotiated in a market jurisdiction through a local subsidiary, but not formally concluded in that jurisdiction. Instead, an automated system managed overseas by the parent company could be responsible for the finalisation of these contracts. Such arrangements allowed a business to avoid a dependent agent PE under Article 5(5). Where the recommendations of Action 7 are implemented, these structures and arrangements would result in a PE for the foreign parent company if the local sales force habitually plays the principal role leading to the conclusion of contracts in the name of the parent company (or for the transfer of property or provision of services by the parent company), and these contracts are routinely concluded without material modification by the parent company.

271. Action 7 also recommended an update of the specific activity exemptions found in Article 5(4) of the OECD Model, according to which a PE is deemed not to exist where a place of business is used solely for activities that are listed in that paragraph (e.g., the use of facilities solely for the purpose of storage, display or delivery of goods, or for collecting information). The proposed amendment prevents the automatic application of these exemptions by restricting their application to activities of a "preparatory or auxiliary" character.[8] This change is particularly relevant for some digitalised activities, such as those involved in business-to-consumer (B2C) online transactions and where certain local warehousing activities that were previously considered to be merely preparatory or auxiliary in nature may in fact be core business activities. Under the revised language of Article 5(4), these types of local warehousing activities carried out by a non-resident no longer benefit from the specific activity exemptions usually found in the PE definition if they are not preparatory and auxiliary in nature. This would be the case, for example, for a large warehouse maintained by a non-resident enterprise in a market jurisdiction in which a significant number of employees work for the main purpose of storing and delivering goods owned and sold by the non-resident enterprise and that a warehouse constitutes an essential part of the non-resident enterprise's sales/distribution business.

272. The various measures outlined in the final 2015 BEPS Action 7 Report are currently being implemented in a number of existing tax treaties through the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the MLI, Box 3.1), as well as in the course of bilateral tax treaty negotiations. Based on the provisional positions of the jurisdictions that have signed the MLI[9], however, it is estimated that the changes recommended under Action 7 will only be implemented in a fairly limited number of bilateral treaty relationships. The latest projections are as follows:

- For the revised dependent agent PE definition (Article 5(5) of the OECD Model): It is estimated that, based on the positions taken so far, this revised definition would apply to around 17**%** of the 1 246 tax agreements currently covered by the MLI (i.e., approximately 206 bilateral tax agreements).
- For the revised provision defining specific-activity exemptions (Article 5(4) of the OECD Model): It is estimated that, based on the positions taken so far, this revised provision would apply to around 22**%** (i.e., approximately 277 bilateral tax agreements).[10]

273. While these early projections indicate a low adoption rate, they do not necessarily reflect the full degree of implementation or the impact of the MLI over time. It is possible, for instance, that jurisdictions that have reserved on the PE related provisions of the MLI will withdraw their reservations following the completion by the Inclusive Framework on BEPS of its work on "Attribution of Profits to Permanent Establishments".[11] Further, some digitalised MNEs have already started restructuring their trade structures based on remote sales in some countries (e.g., Amazon, e-bay, Facebook, Google), although not all market jurisdictions have experienced and benefited from such restructuring to the same extent.[12]

274. Furthermore, the adoption rate of the new PE definition may also increase over time as governments will base treaty negotiations on the 2017 OECD Model incorporating those changes. The OECD Model has long served as the basis for the negotiation of bilateral tax treaties, and the expectation is that countries will continue to draw on the OECD Model for future tax treaty negotiations.[13]

Box 3.1. The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting

Developed by over 100 countries and jurisdictions, the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (the Multilateral Instrument, or MLI) and its accompanying Explanatory Statement, is a ground breaking tool, allowing countries to rapidly amend their bilateral tax treaty network with a single instrument.

During a signing ceremony at the OECD on 7 June 2017, 77 countries and jurisdictions expressed their commitment to update their tax treaty networks in line with the BEPS package, 67 of which signed the MLI, with a further 9 jurisdictions formally expressing their intention to sign in the near future.[1] Since the first signing ceremony, 9 additional jurisdictions have signed the MLI which now covers 78 jurisdictions. More jurisdictions are expected to join the MLI in the coming period. Based on the current signatures, more than 1 200 existing tax treaties will already be modified by the MLI, and additional treaties will be covered as more parties join the MLI.

The MLI reflects the treaty-related minimum standards that were agreed as part of the BEPS package and to which all countries and jurisdictions within the Inclusive Framework on BEPS have committed. These standards relate to the prevention of treaty abuse (Action 6)[2] and the improvement of dispute resolution (Action 14). The MLI further enables signatories to implement all the other tax treaty measures developed in the BEPS Project that are not minimum standards. These include, *inter alia*, measures relating to hybrid mismatch arrangements that regulate the claiming of treaty benefits (e.g., provisions on dual-resident companies and fiscally transparent entities), measures to make Mutual Agreement Procedures (MAP) more effective, including a mandatory binding MAP arbitration provisions (which so far 28 jurisdictions have committed to implementing) and measures to prevent the artificial avoidance of permanent establishment status through *commissionaire* arrangements. Recognising the need to accommodate a variety of tax policies, the MLI is a flexible yet robust instrument that provides the possibility to apply optional and/or alternative provisions where there are multiple ways to address BEPS, while not diverging from the BEPS minimum standards. Further, given the importance of countering treaty abuse and improving dispute resolution, some signatories prioritise the implementation of the minimum standard measures, while planning to opt in for other provisions at a later stage.

The jurisdictions that have signed the MLI are now preparing for its ratification in accordance with their domestic processes. For the modifications made by the MLI to have effect with respect to an existing bilateral tax treaty, both parties to the treaty will have to ratify the MLI in accordance with their domestic procedures for which the timing will vary between countries. It is anticipated that the first modifications may enter into effect in 2018.

The OECD is the depositary of the MLI and will continue to work with the signatories to ensure the clarity of the MLI and its relation with existing treaties, maximising the impact of the treaty-related BEPS measures.

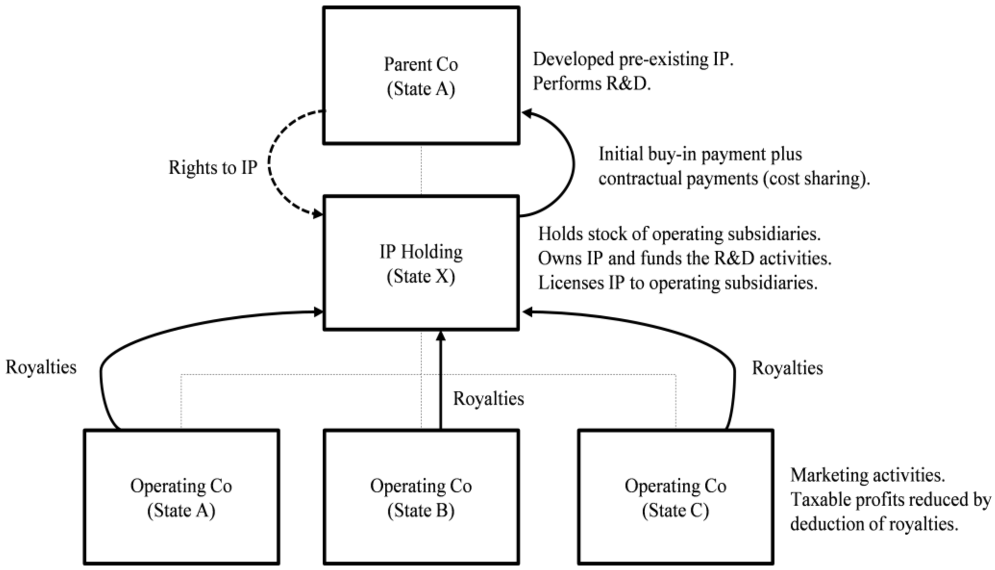
1. China's signature also covers Hong Kong, China. The provisional MLI positions are available online (OECD, 2018[3]). Bermuda has indicated that it has bilaterally invited all of its DTA partners to update its treaties to the standard articulated by the MLI.
2. The 2015 BEPS Action 6 Report (OECD, 2015[4]) provides for a simplified and a detailed Limitation on Benefits provision. Given that the detailed Limitation on Benefits provision requires substantial bilateral customisation, which would be challenging in the context of a multilateral instrument, the MLI does not include a detailed Limitation on Benefits provision.

Assuring that transfer pricing outcomes are in line with value creation (Actions 8-10)

275. The BEPS Project identified a number of structures employed by MNEs to separate income from the underlying economic activities. For example, it is possible to create BEPS opportunities by contractually allocating assets and risks to affiliated entities located in low-tax jurisdictions in a way that is not fully reflected in the actual conduct of the parties. Business models where intangible assets are central to the firm's profitability, such as those of highly digitalised businesses, have typically involved the transfer of intangible assets or their associated rights to entities in low-tax jurisdictions that may have lacked the capacity to control the assets or the associated risks. To benefit from a lower effective tax rate at the group level, affiliates in low-tax jurisdictions had an incentive to undervalue the intangibles (or other hard-to-value income-producing assets) transferred to them. At the same time, they could claim to be entitled to a large share of the MNE group's income on the basis of their legal ownership of the intangibles, as well as on the basis of the risks assumed and the financing provided (i.e., cash boxes). In contrast, affiliates operating in high-tax jurisdictions could be contractually stripped of risk, and avoid claiming ownership of other valuable assets.

276. Figure 3.2 shows the use of a cost-sharing arrangement to transfer the valuable intangibles initially developed by a member of a MNE group to a capital rich associated enterprise (IP Holding) situated in a low-tax jurisdiction (State X). These intangibles are subsequently licensed to other operating subsidiaries engaged in marketing and sales activities, without the IP Holding company being effectively involved in the performance of the development, enhancement, maintenance, protection or exploitation (DEMPE) functions related to those intangibles. This enabled the MNE group to park the bulk of its profits in a "cash box". This is the affiliate in the low-tax jurisdiction (IP Holding) that holds the capital to fund the activities of the group. The affiliate has ownership over the most valuable assets, even in situations where such contractual allocation of assets and risks did not fully reflect the actual conduct of the parties.

Figure 3.2. Scenario involving a cash box not performing any DEMPE functions



277. Actions 8-10 of the BEPS Action Plan developed guidance to minimise the instances in which BEPS would occur as a result of these structures. In particular, the guidance seeks to address the prevention of BEPS by moving intangibles among group members (Action 8), the allocation of risks or excessive capital among members of an MNE group (Action 9) and transactions which would not occur between third parties (Action 10). All these work streams gave special consideration to the specificities of highly digitalised business models.

278. The guidance developed under BEPS Actions 8-10 was incorporated into the OECD Transfer Pricing Guidelines in 2016 to ensure that transfer pricing outcomes are aligned with value creation. While the Transfer Pricing Guidelines play a major role in shaping the transfer pricing systems of OECD and many non-OECD jurisdictions, the effective implementation of these changes depends on the domestic legislation and/or published administrative practices of the countries. Whereas in several jurisdictions the amendments became immediately effective, some jurisdictions may need to take further legislative or administrative action to bring the changes into effect. In any case, all Inclusive Framework jurisdictions have been requested to complete a questionnaire that will allow the monitoring of the status of implementation of the guidance developed under BEPS Actions 8-10.

279. Overall, tax administrations are now better equipped to address profit shifting by MNE groups through mechanisms such as:

- Identification of actual business transaction between the associated enterprises by supplementing, where necessary, the terms of any contract with evidence of the actual conduct of the parties.
- An analytical framework to determine which associated enterprise assumes risk for transfer pricing purposes, with contractual allocations of risk being respected only when they are supported by actual decision-making.
- Guidance to accurately determine the actual contributions made by an associated enterprise that solely provides capital without functionality. Specifically, if the capital provider does not exercise control over the investment risks that may give

rise to premium returns, that associated enterprise should expect no more than a risk-free return.

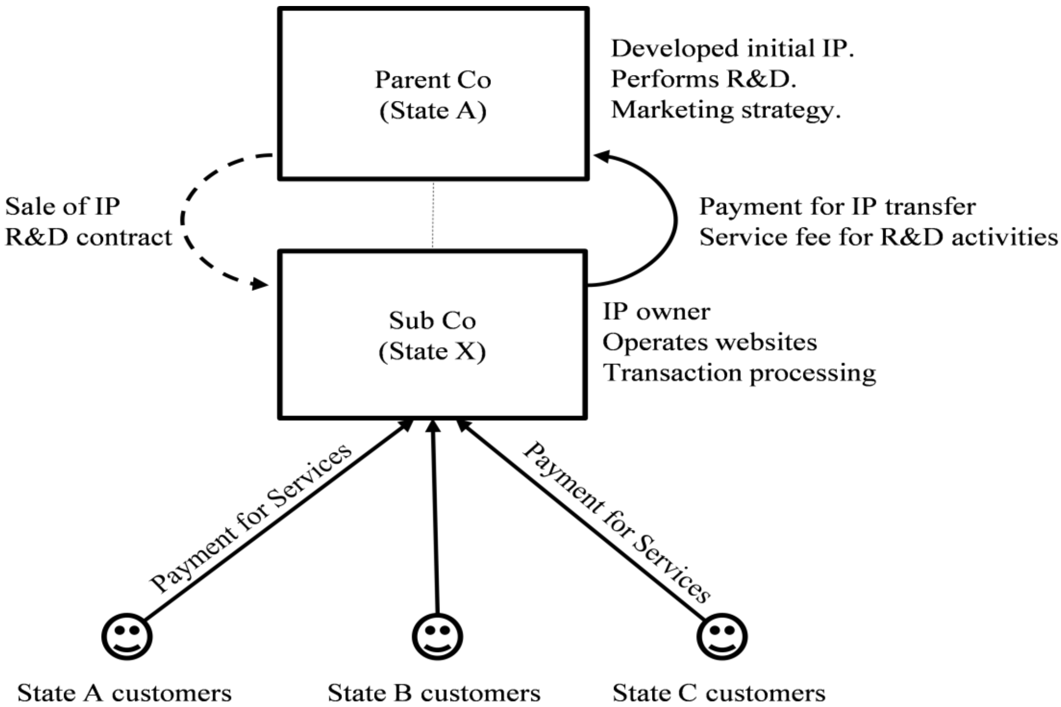
- Guidance on transactions that involve the use or transfer of intangibles which ensures that legal ownership of an intangible by an associated enterprise alone does not determine entitlement to returns from the exploitation of this intangible.

280. Anecdotal evidence is already available on the impact that these tools are having on the transfer pricing positions of some MNEs involved in highly digitalised activities (e.g., "on-shoring of assets", see Sub-section 3.5.1.).

Strengthening controlled foreign company rules (Action 3)

281. The mobility and flexibility inherent in highly digitalised business models enables these MNEs to manage their global operations on an integrated basis from a central location that may be removed geographically from both the locations in which the research and development operations are carried out and the location in which their suppliers or customers are located. Figure 3.3 shows that an MNE group can allocate substantial income to a subsidiary in a low-tax jurisdiction (State X, the CFC jurisdiction) by locating key intangibles there and using those intangibles to remotely sell digital goods and services through the Internet to third-party customers located in other jurisdictions. Typically, the subsidiary in State X has limited personnel and does not itself perform any significant business activities in relation to the online sales (e.g., functions performed by local staff, marketing and promotion for local customers, after-sale services).

Figure 3.3. Scenario exploiting the lack of robust controlled foreign company rules



282. Under this structure the income arising from the remote sales will not give rise to any tax liability in the jurisdictions where the customers are located (State A, B and C), while being subject to minimal or no taxation in the CFC jurisdiction (State X). Additionally, the payments will generally not be subject to domestic taxation at the level

of the shareholders (Parent company) in the ultimate residence country (State A). This result can be achieved because many jurisdictions either do not have a CFC regime, have a regime with inadequate coverage of certain categories of passive or highly mobile income
(e.g., online sales of products and services to third-party customers), or have a regime that can be easily avoided using hybrid mismatch arrangements. For all these reasons, the lack of comprehensive and effective CFC rules was identified in the 2015 BEPS Action 1 Report as a relevant issue in the existing framework.

283. The 2015 BEPS Report on Action 3 provided recommendations in the form of six building blocks, including a definition of CFC income which sets out a non-exhaustive list of approaches or combination of approaches on which CFC rules could be based. Specific consideration is given to a number of measures that would target income typically earned in the digital economy, such as income from intangible property and income earned from the remote sale of digital goods and services to which the CFC has added little or no value. These approaches include categorical, substance, and excess profits analyses that could be applied on their own or in combination with each other. With these approaches to CFC rules, mobile income typically earned by highly digitalised businesses would be subject to tax in the jurisdiction of the ultimate parent company. This would counter offshore structures popular among many highly digitalised MNEs that result in exemption from taxation, or indefinite deferral of taxation in the residence jurisdiction. Comprehensive and effective CFC rules in the residence country of the ultimate parent company would also reduce the incentive to shift profits from a market country into a low-tax jurisdiction.

284. Countries seeking to amend their CFC rules have already shown interest in the recommendations regarding income from online sales and services. Under the EU Council's Anti-Tax Avoidance Directive (ATAD1),[14] for example, all of the 28 EU Member States are required to introduce CFC rules that draw heavily on the recommendations of Action 3.[15] Article 7 of that Directive provides two alternative methods to define the income earned by a CFC. One is based on formal classifications and covers a broad range of income categories, including "*royalties and any other income generated from Intellectual Property*" and "*income from invoicing companies that earn sales and services income from goods and services purchased from and sold to associated enterprises*". This method may in some cases cover sales income generated primarily from the use of underlying intangible property (i.e., "embedded royalties") but is limited by a substance carve-out rule available to a CFC that "*carries on a substantive economic activity supported by staff, equipment, assets and premises, as evidenced by relevant facts and circumstances*". The other method is based on a standalone substance test which captures income "*arising from non-genuine arrangements which have been put in place for the essential purpose of obtaining a tax advantage*". In accordance with the best practices outlined in the 2015 BEPS Action 3 Report, it looks at the significant people functions within the group to determine whether the CFC is conducting non-genuine arrangements. This method may not always reach income from online services, where the CFC may typically be established with the necessary substance to comply with transfer pricing rules.

285. More recently, as part of its broader tax reform legislated in 2017, commonly referred to as the Tax Cuts and Jobs Act ("TCJA"), the United States has implemented a number of key measures to prevent base erosion, which will help to address double non-taxation in US-headquartered MNEs, as well as substantially reduce the incentive to shift profits into low-tax jurisdictions. This includes a new feature in its CFC regime based on

an excess profit analysis: the tax on global intangible low-taxed income ("GILTI").[16] This tax on excess returns ensures a combined (foreign and US) effective corporate tax rate of at least 13.125% (until 2026, and 16.4% thereafter)[17] on the excess of a shareholder's net CFC income over a routine or ordinary return. The simplified method used to determine such excess returns could include income from intangibles and risk-shifting derived outside the United States, including income from online sales and services, generally irrespective of the level of activity in the CFC. The GILTI tax is, however, applied on a global basis rather than using a country-by-country approach, leaving the possibility to locate investment in low-tax jurisdictions and to blend with excess profits from low-tax and high tax jurisdictions. For previously untaxed foreign earnings accumulated overseas before 2018 that benefited from a US deferral under previous rules (potentially combined with no or minimal foreign taxes), the US tax reform also includes a transition tax or deemed repatriation rule. This transition tax imposes a one-time tax on post-1986 deferred foreign earnings computed in a manner that ensures an effective tax rate of 15.5% for liquid assets (i.e., foreign earnings held in the form of cash and cash equivalent) and an effective tax rate of 8% for illiquid assets (i.e., remaining earnings reinvested in the business). This tax liability can be paid in instalments over an eight-year period.

286. Similarly, Japan amended its CFC rules in March 2017 and implemented many of the recommendations of Action 3, such as new provisions on the taxation of "abnormal income" earned by a foreign subsidiary. These provisions were designed to capture extraordinary excess profits earned by a foreign subsidiary, thus addressing BEPS risks raised by intangible property and online sales and services[18]. Other countries (e.g., Colombia, Chile) have also recently adopted aspects of the Action 3 recommendations into their domestic law, but they have not implemented the specific recommendations regarding intangible property income and income earned from online sales and services.

3.3.2. Other relevant direct tax measures

287. The flexibility of many digitalised businesses in choosing the location of their key resources creates an incentive to use conduit companies located in a country with a favourable treaty network to obtain tax treaty benefits generally granted only to resident companies (treaty-shopping arrangements). To address this BEPS concern, a minimum standard was agreed under Action 6 on anti-abuse provisions that countries must include in their treaties.[19] In addition, the minimum standard requires the inclusion of an explicit statement in the preamble of each treaty clarifying that the treaty is not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance (such as treaty-shopping strategies). Taken together, these requirements will ensure that the source country can apply its domestic law in cases of avoidance, unconstrained by treaty rules aimed at preventing double taxation.

288. So far, the implementation of this minimum standard has been widespread. Countries have started to implement the necessary treaty changes either through the MLI or by updating their tax treaties through bilateral negotiations. To date, the tax treaties of 78 jurisdictions are covered by the MLI, which will update more than 1 200 bilateral tax treaties, ensuring that approximately one-third of existing treaties will be brought into line with the Action 6 minimum standard.

289. In addition, as intangibles and income arising from their exploitation are by definition geographically mobile, digitalised MNEs have an incentive to locate their

intangibles in tax jurisdictions where preferential regimes for intellectual property (IP) income are available. To address this BEPS issue, a minimum standard was agreed under Action 5 which requires that preferential tax regimes provide benefits only where the taxpayer undertakes substantial activities (the nexus approach). According to this standard, tax benefits may be provided to income derived from IP assets only to the extent that the related, underlying research and development (R&D) activities are undertaken primarily by the taxpayer itself or in the tax jurisdiction providing the benefits. As set out in the 2017 Progress Report on Harmful Tax Practices (OECD, 2017[5])[20] almost all OECD and G20 countries with IP regimes are now fully compliant with the "nexus approach" (a total of 19 out of 21 such regimes). Among new members of the Inclusive Framework on BEPS, 31 IP regimes have been identified; virtually all of these regimes (29 out of the 31) do not comply with the nexus approach and are being abolished or amended.

290. Finally, as part of the Action 5 minimum standard, members of the Inclusive Framework on BEPS have committed to the compulsory, spontaneous exchange of information on tax rulings that could present BEPS risks. For the first time, information on rulings in key risk categories (e.g., cross-border unilateral Advance Pricing Arrangements (APAs)), including certain rulings issued since January 2010 will be spontaneously exchanged with all relevant jurisdictions, subject to the necessary legal frameworks being in place. The first annual report on the peer review of the rulings transparency framework was released on 4 December 2017. By 31 December 2016, almost 10 000 relevant rulings had been identified and almost 6 500 have been exchanged between tax administrations around the world, providing authorities with useful information about potential risks to their own tax base. With additional and timelier information, the authorities will be able to also take action more efficiently against BEPS arrangements. This enhanced international co-operation may have a significant impact on taxpayers' behaviour, including that of highly digitalised companies.

3.4. Implementation of the recommended solutions and available options to address the VAT challenges of the digital economy

291. The 2015 BEPS Action 1 Report outlined how highly digitalised businesses could structure their affairs so that little or no VAT is paid on remotely delivered services and intangibles. To address these BEPS risks, the 2015 BEPS Action 1 Report concluded that the solution is provided by the OECD's International VAT/GST Guidelines (OECD, 2017[2]).[21] In particular, the implementation of Guidelines 3.2 and 3.4 on place of taxation for business-to-business (B2B) supplies of services and intangibles will minimise such BEPS risks and ensure that the right to levy VAT is allocated to the jurisdiction where these services and intangibles are used for business purposes, irrespective of how the supply and acquisition of these services and intangibles is structured.[22] The OECD International VAT/GST Guidelines have been endorsed by over 100 countries, jurisdictions and international organisations and serve as reference for an increasing number of countries around the world for designing and implementing legislation addressing the abovementioned BEPS risks.

292. In addition, the 2015 BEPS Action 1 Report concluded that one of the broader tax challenges arising from digitalisation is the challenge associated with the collection of VAT on cross-border trade in goods, services and intangibles, particularly where they are acquired by private consumers from suppliers abroad. Digitalisation has magnified this challenge as the evolution of technology has dramatically increased the capability of

private consumers to shop online and the capability of businesses to sell to customers around the world without the need to be physically present or otherwise in the consumer's country. Considering also that digitalised foreign seller may have no nexus in a market jurisdiction and that a market jurisdiction may have limited means to require a foreign seller to apply and remit VAT on services and intangibles supplied to final consumers in that jurisdiction, no or an inappropriately low amount of VAT may be collected on these supplies by such sellers, with adverse effects on countries' VAT revenues. This can also result in an uneven playing field between domestic suppliers, who have an obligation to collect VAT on supplies to local customers, and foreign suppliers who may have no such obligation or where it may be difficult to enforce VAT-related obligations.

293. Against this background, new guidelines and VAT collection mechanisms were agreed in the 2015 BEPS Action 1 Report. In accordance with the destination principle, they allow a jurisdiction's tax authorities to collect VAT on services and intangibles supplied cross-border by foreign suppliers to final consumers (business-to-consumer or B2C) in that jurisdiction (i.e., the jurisdiction where the customer is located). The 2015 BEPS Action 1 Report highlights that the most efficient and effective levels of compliance by foreign suppliers can be achieved if the relative obligations in the jurisdictions of taxation are limited to what is strictly necessary for the effective collection of the tax. Therefore, the 2015 BEPS Action 1 Report recommends that the foreign supplier be allowed to register for VAT in the market jurisdiction under a simplified registration and compliance regime. This simplified registration and collection regime operates separately from the traditional registration and collection regime without the same rights, such as input tax recovery, or obligations such as full reporting. These measures have now also been incorporated in the OECD International VAT/GST Guidelines.

294. The implementation of these agreed measures enables the market country to secure the VAT revenues arising from B2C digital supplies to market country consumers. It also levels the playing field between domestic and foreign suppliers because foreign suppliers are required to charge VAT on sales to local customers as domestic suppliers do. Moreover, the recommended mechanisms mitigate the compliance costs for digital suppliers by limiting the compliance obligations to what is strictly necessary for the effective collection of the tax.

295. This work has already greatly enhanced compliance levels by promoting more consistent and effective implementation of the agreed approaches.

296. To date, over 50 jurisdictions, including the overwhelming majority of OECD and G20 countries, have adopted rules for the VAT treatment of B2C supplies of services and intangibles by foreign suppliers in accordance with the OECD International VAT/GST Guidelines. These jurisdictions include the 28 EU Member States, Albania, Andorra, Argentina, Australia, Bahamas, Belarus, China, Colombia, Ghana, Iceland, India, Japan, Kenya, Korea, Mexico, New Zealand, Norway, Russia, Saudi Arabia, Serbia, South Africa, Switzerland, Tanzania and Turkey. Among those that have not yet implemented the rules, many jurisdictions are now considering a reform in light of the principles of the Guidelines. This is notably the case for Costa Rica, Indonesia, Israel, Malaysia, Singapore,[23] Thailand, the Philippines, Tunisia, and a number of the Gulf Cooperation Council countries. Columns 1 and 2 in the table in Annex Table 3.B.1 provide a summary of jurisdictions that have implemented or are considering implementing the recommended solutions.

297. The early data on the impact of these measures is very promising. This is the case, for example, in South Africa where the revenue collected through the application of the recommended principles and collection mechanisms amounted to ZAR 585 million for 2016/2017. In the EU, as the earliest adopter of these principles, has identified the total VAT revenue declared via its simplified compliance regime in 2015 (the EU regime's first year of operation) was in excess of EUR 3 billion (Deloitte, 2016[6]). Approximately 70% of the total cross-border B2C supplies of services and intangibles that are in scope of the EU regime are captured.[24] Moreover, this regime has allowed businesses to achieve a notable reduction in their compliance burden, which according to estimates is 95% lower than what it would have been without such simplification measures.[25]

298. The experiences shared by various jurisdictions indicate that essential elements for the successful implementation of a VAT collection mechanism include: consultation with the business community in the design phase; proper communication strategy to publicise its implementation and to explain key compliance aspects; and the availability of clear guidance for taxpayers.

299. As evidenced by the increasing number of jurisdictions that have already implemented such mechanisms or that are considering doing so, the effective implementation and operation of these rules and mechanisms are considered priorities for many countries around the world, to ensure that VAT is properly paid on the continuously growing online trade in services and digital products. There is thus a need for both governments and businesses to promote the coherent and consistent implementation and operation of these rules across jurisdictions. This will not only further enhance the levels of compliance but will also support tax authorities' enforcement capacity, notably by facilitating international administrative co-operation.

300. The need for coherence and consistency in the implementation of the VAT rules across countries resulted in the development of further guidance in 2017 to support governments in the implementation of best practices in the design and operation of the collection mechanism recommended by the 2015 BEPS Action 1 Report and the OECD International VAT/GST Guidelines. This guidance has been included in the report on "*Mechanisms for the Effective Collection of VAT/GST Where the Supplier Is Not Located in the Jurisdiction of Taxation*"[26] published on 24 October 2017. It builds on the research, analysis and experience of the jurisdictions that have or are in the process of implementing a simplified registration and collection regime and the businesses that have registered or are considering registering for such regimes. This new implementation guidance has been welcomed by tax administrations as well as the business community as a significant further step to support enhanced compliance levels while limiting compliance costs for digital suppliers by promoting the consistent and coherent implementation of these collection mechanisms across jurisdictions.

301. As recognised also by the 2015 BEPS Action 1 Report, the exchange of information and administrative co-operation can and should play a significant role in addressing and overcoming the challenges in operating and policing these collections mechanisms, notably to support the enforcement in relation to the foreign suppliers and the monitoring of compliance levels. There are a number of existing OECD mechanisms for the exchange of information and mutual administrative cooperation which were also identified in the OECD International VAT/GST Guidelines as potentially very helpful to address enforcement challenges.[27] Activating these existing instruments and providing a framework for their practical application for VAT purposes is essential in this undertaking. Scoping OECD work in this area is still ongoing.

302. Further ongoing work to promote the consistent implementation and operation of the recommended rules across jurisdictions focuses on the role of online platforms and other intermediaries in the VAT collection process, with an emphasis on the design and implementation of measures to secure the efficient and effective collection of VAT on the trade generated and executed by platforms and intermediaries. A number of jurisdictions have started collecting VAT from digital platforms and have reported positive outcomes in securing additional tax revenues. Some jurisdictions are also following in this direction and some others are expected to do so in the future.

303. Both tax administrations and the business community have signalled an urgent need for work on consistent solutions in this area which should be both efficient and effective in securing tax revenue without creating undue administrative and compliance costs. Against this background, the OECD Working Party No.9 on Consumption Taxes (WP9), in close consultation with the business community through the Technical Advisory Group to WP9 (TAG) is currently analysing (i) the functions performed by digital platforms in online sales and delivery chains and (ii) the possible role of platforms performing these functions in the collection of VAT on online sales including an overview of approaches implemented or considered by tax authorities around the world. It is anticipated that this work will result in a report which will include possible guidance and approaches based on good practice. This work is scheduled to be completed within 2018 and is not intended to delay or impinge on jurisdictions' current domestic policy development and implementation strategies.[28]

304. Additionally, the 2015 BEPS Action 1 Report outlined options to facilitate the collection of VAT on the importation of low-value goods from online sales. Based on reducing or removing VAT exemption thresholds, these approaches rely on the intervention of online vendors or other parties involved in the supply chain for online sales, such as e-commerce platforms or express couriers. A number of countries have announced or are actively considering the removal of their VAT exemption thresholds for the importation of low-value goods from online sales and the implementation of approaches for a more efficient collection of VAT for low-value imports. For example, the 28 EU Member States have recently approved proposals for modernising VAT collection in cross border e-commerce. These proposals provide for the extension of the Mini-One-Stop-Shop (MOSS) registration system to cover imports of low-value goods and all cross border services to final users and to remove the exemption for low value consignments with effect from 2021. Australia has already enacted legislation on the GST treatment of low-value imported goods, with effect from 1 July 2018. Switzerland will change its rules regarding the treatment of low value imports as of 1 January 2019.

305. Notably in the area of cross-border supplies of services and intangibles, the overall progress described in this section has facilitated greater compliance with the tax rules by businesses in the booming e-commerce sector and has ensured that consumption taxes can be levied effectively in the country of consumption.

3.5. Preliminary findings on the impact of the BEPS package in the context of digitalisation

306. As previously explained, a systematic assessment of the effect of the various BEPS Actions will only be possible when appropriate micro- and macro-level data becomes available, including information on the behaviour of taxpayers gathered by tax authorities, for example through their audit capacity, the Country-by-Country (CbC) reports or the standard tax returns. Nonetheless, this section provides a preliminary

assessment of the effectiveness of the BEPS measures, with a distinct analysis of their impact on the BEPS issues and separately, on the broader direct tax challenges related to nexus.

3.5.1. Impact of the BEPS package on BEPS issues

307. Although the implementation of the BEPS package has only very recent begun, there are already indications of its impact on the tax planning and structuring decisions of MNE groups. The implementation of the measures described in this Part has made a number of cross-border tax planning schemes unfeasible or no longer financially attractive, including for highly digitalised businesses. This will restore both source and residence taxation in a number of cases where cross-border income would otherwise go untaxed or would be taxed at very low rates. There are also expectations that this should help establishing a more level playing field where domestic SMEs and MNEs are taxed similarly. Examples of common tax structures effectively being curtailed include:

- **IP holding companies using preferential tax regimes such as "IP regimes"** (see the example in Annex Figure 3.A.1). Tax benefits arising from intellectual property (IP) regimes can only be granted to the extent that underlying research and development expenditure activities are undertaken primarily by the taxpayer itself or in the tax jurisdiction granting the tax benefits.[29] This is the new "nexus" approach.
- **Treaty-shopping structures** (see the example in Annex Figure 3.A.3). It is increasingly difficult to establish conduit companies and/or special purpose holding companies in low-tax jurisdictions with the aim of avoiding withholding taxes on passive income. In addition, any tax rulings or similar arrangements granted by tax authorities reducing the effective taxation of taxpayers now have to be disclosed.
- **The use of "cash boxes"** (see the example in Figure 3.2). A cash-rich entity in a low-tax jurisdiction that provides funding for the development of valuable intangibles but does not have the capacity to control the risks associated with its investment is now accorded no more than a risk-free return on its funds under the revised transfer pricing rules.
- **The use of "trade structures" based on remote sales** (see the example in Figure 3.1). Where the amended dependent agent PE definition (Action 7) has been fully implemented, it will be more difficult for a digitalised business to remotely supply online products and/or services into a market without creating a dependent agent PE in that jurisdiction, if the sales force of a local subsidiary habitually plays the principal role leading to the conclusion of such sales, and the contracts are routinely concluded without material modification by the overseas supplier. The new dependent agent PE threshold may now be met by the overseas supplier even if the local subsidiary does not formally conclude those contracts, and even if the contracts are standard form contracts. It may also be more difficult to avoid a fixed place of business PE in connection with BEPS strategies involving the remote sale of physical goods through online platforms. Where the updated specific-activity exemptions to the PE definition are adopted, it may be difficult for a non-resident enterprise to establish a large warehouse in a market country whilst at the same time avoiding the PE threshold in that country, unless the local activities carried on through that warehouse are preparatory and auxiliary in nature. Finally, it should be noted that the successful implementation of the recommended mechanisms to ensure that VAT is paid on cross-border trade

in services and digital products will remove another important incentive for online retailers to relocate offshore and sell at a distance from the market by closing the gap between the obligations of domestic enterprises and foreign suppliers in connection with sales to local customers.

308. As a result of the BEPS package, MNEs are expected to take steps to align their corporate structures with their real economic activity. In a number of cases, including certain highly digitalised businesses, evidence of this has already emerged. These steps include business restructurings or changes to their transfer pricing positions, usually by re-evaluating the location of people functions, and of risk assumption and risk management.[30] This is corroborated by publicly available information on the relocation of valuable assets (such as intangibles) and risks from low-tax jurisdictions to other jurisdictions where substantial business activities take place, notably in terms of people functions (so-called "on-shoring" of assets).[31] Additional relevant data is expected to emerge over time, notably from the CbC reports which will start to be exchanged across jurisdictions in June 2018. These trends are likely to grow as more countries implement national legislation to adopt the various measures included in the BEPS package.

309. Further responses to the BEPS package include a growing number of cases in which some heavily digitalised MNEs have decided to change or begin changing their trade structures (e.g., Amazon, eBay, Facebook, Google),[32] usually by converting from a remote sales model to a commercial model where online sales with in-country customers are recognised in a local entity (such as a buy-sell distributor).[33] Some countries in which these restructurings have occurred have also seen a broadening of their corporate tax base, as the local taxpayer of the MNE group is no longer characterised as a provider of routine services remunerated on a cost-plus basis. Instead, the income from the sales with in-country customers is recognised at the level of the local taxpayer (subsidiary or PE) after deduction of the relevant expenses (e.g., direct cost of goods sold, direct costs of sales and provision of services, local marketing and promotion). In accordance with the arm's length principle, this generally entails a shift in the market country from a remuneration based on a return on costs to a remuneration based on sales, and arguably leads to a higher exposure to risk associated with commercial opportunities (i.e., higher positive or negative returns). Other countries, however, have seen similar restructuring with no (or minimal) corresponding broadening of their corporate tax base, highlighting the uncertainty that currently surrounds the attribution of profits to a local taxable presence (i.e. PE or subsidiary). For instance, in situations where the contract conclusion is largely automated and does not involve inventory management (e.g. software-as-a-service), it is unclear whether the remuneration paid to the local buy-sell subsidiary or PE (after restructuring) will in practice be significantly greater than the remuneration paid to a local subsidiary performing support functions for similar sales contracted offshore (before the restructuring).

310. Further, it is recognised that not all market jurisdictions have benefitted from the positive results generated by these restructurings. This is largely because the low rate of adoption of the new dependent agent PE definition and of the updated specific activity exemptions in the context of the MLI has led to limited material changes in the incentive to adopt trade structures based on remote sales in a large number of countries. At the same time, the recent implementation of robust CFC rules in some key countries is expected to significantly reduce the incentive to shift profits derived from online sales into low-tax jurisdictions.

3.5.2. Impact of the BEPS package on the broader direct tax challenges

311. The lack of currently available data limits any assessment of the impact of the BEPS package on the broader direct tax challenges raised by digitalisation. However, in the area of VAT, useful and reliable information has begun to emerge from the widespread implementation of the new guidelines and collection mechanisms that facilitate taxation of cross border trade of digital services and products in accordance with the destination principle. As described above, the early data shows significant additional revenue raised by jurisdictions implementing the OECD International VAT/GST Guidelines. The additional revenue figures estimated by the EU and South Africa unequivocally show the importance of the OECD International VAT/GST Guidelines in substantially strengthening the revenue raising abilities of adopting countries. Not only are the Guidelines and the related work instrumental in securing additional revenues for the adopting countries, but they are also playing a crucial role in reducing the business compliance burden, with some estimates pointing to a significantly lower compliance burden compared to a situation where such simplification measures had not been implemented.[34] Lower compliance costs often translate in a lower cost of capital and therefore, in more resources for investment and growth.

312. Separately, there has been a limited impact of the implementation of the other measures of the BEPS package on the broader direct tax challenges. Clearly, a number of countries have seen significant benefits from the on-shoring of assets and the reorganisation of trade structures, which can potentially result in additional income for both source and residence taxation. These benefits, however, have so far been concentrated in a limited number of jurisdictions. More importantly, there is a growing perception that the BEPS measures will not address the tax challenges that have a broader impact and relate primarily to the allocation of taxing rights among different jurisdictions (in particular nexus, data, and characterisation for direct tax purposes). This is largely due to two factors. First, the measures recommended in the BEPS project were designed to close the "gaps" and "loopholes" identified in the tax system that created opportunities for double non-taxation (i.e. tax avoidance), not to resolve the broader direct tax challenges raised by digitalisation. In particular, none of the direct tax measures of the BEPS package were conceived to address the circumstances where there is no physical presence of the foreign enterprise in the country where customers are located (i.e., to address the nexus issue), and/or to rebalance the impact of operational scale without mass on the distribution of taxing rights. Similarly, none of the BEPS measures were conceived to clarify the possible treatment and relative value of data and user participation (i.e., profit attribution issue). Also the revised PE definition may not necessarily result in an increase of the tax base in the market jurisdiction to reflect the greater reliance of some digitalised businesses on data collection and user participation. Second, the low level of adoption of some key BEPS measures for tackling BEPS issues exacerbated by digitalisation – i.e., the PE-related treaty provisions – has had limited impact in reducing the pressure on source taxation caused by the growing importance of cross-border trade in digital products and services.

313. The ability of the international tax rules to address the broader tax challenges raised by digitalisation is discussed further in Chapter 5. In the absence of a more fundamental reform at an international level, several countries have taken steps to introduce measures that are potentially relevant to the digitalisation of the economy as set out in Chapter 4.

Annex 3.A. Implementation of the direct tax measures contained in the BEPS package

314. The OECD/G20 Base Erosion and Profit Shifting ("BEPS") Project was launched following a request by G20 Leaders in June 2012 to identify the key issues that lead to BEPS. The OECD's February 2013 Report, *Addressing Base Erosion and Profit Shifting*, became the basis for the 15-point BEPS Action Plan which was endorsed by the OECD Council, as well as by G20 Leaders at their July 2013 Summit in Saint Petersburg.

315. Organised around three pillars, the objectives of the BEPS Project were to (i) reinforce the coherence of corporate income tax rules at the international level, (ii) realign taxation with the substance of the economic activities, and (iii) improve transparency. As a result of an ambitious work programme that was completed in only two years, the BEPS package of 15 measures was delivered in October 2015.

316. In 2016, the Inclusive Framework on BEPS was established with a broad mandate to ensure the consistent, widespread and effective implementation of the BEPS package that had been released in October 2015. To date, 113 countries and jurisdictions representing more than 93% of global GDP have joined the Inclusive Framework on BEPS and are taking action to close the loopholes and address the mismatches in international tax law that have facilitated BEPS.

317. For the four minimum standards[35], implementation is ensured by a rigorous peer review and monitoring framework[36] and the agreed monitoring procedures already well-advanced. Beyond the four BEPS minimum standards, many countries have also begun implementing other components of the BEPS package, which have the potential to alter the global corporate tax landscape significantly (e.g., the revised Transfer Pricing Guidelines under Action 8-10, anti-hybrid mismatch rules under Action 2, interest limitation rules under Action 4). Finally, standard-setting work[37] and the delivery of practical guidance are key elements of the Inclusive Framework's on-going work to ensure that all countries and jurisdictions, including developing countries, are supported in the implementation process.

318. All members of the Inclusive Framework on BEPS have agreed to implement the BEPS minimum standards. The minimum standards were agreed in particular to tackle avoidance in cases where no action by some countries would have created negative spill overs on other countries, with wider implications for the level and distribution of welfare across nations. To ensure consistent implementation of these minimum standards, Inclusive Framework on BEPS members agreed to a peer review process for the period 2016-20.[38] Peer reviews of Actions 5, 13 and 14 are now underway, while the peer review of the Action 6 minimum standard will commence in 2018.

319. The minimum standards are organised around three pillars:

- **Better aligning taxation with value creation**, which includes the substantial activity requirement for preferential regimes (Action 5) and measures to prevent treaty shopping (Action 6);
- **Improving transparency**, which includes Country-by-Country Reporting (Action 13) and exchange of information on certain tax rulings (Action 5);
- **Ensuring greater certainty**, which includes measures to enhance the effectiveness of dispute resolution (Action 14).[39]

320. Chapter 3 of this report contains a detailed description of the implementation of the measures of the BEPS package that are most relevant to digitalisation (i.e., Action 7, Actions 8-10, and Action 3), together with an assessment of their impact on the behaviour of highly digitalised businesses. In addition, given that the BEPS measures form part of a coherent package in which all aspects are expected to have an impact, this annex describes the current progress in the implementation of the measures of the BEPS package that are not specifically addressed in Chapter 3, namely the minimum standards on harmful tax practices (Action 5), tax treaty abuse (Action 6) and Country-by-Country reporting (Action 13), as well as domestic law measures other than CFC rules (Actions 2, 4 and 12). The discussion of these measures includes, where relevant, a focus on the significance of these measures for digitalised businesses.

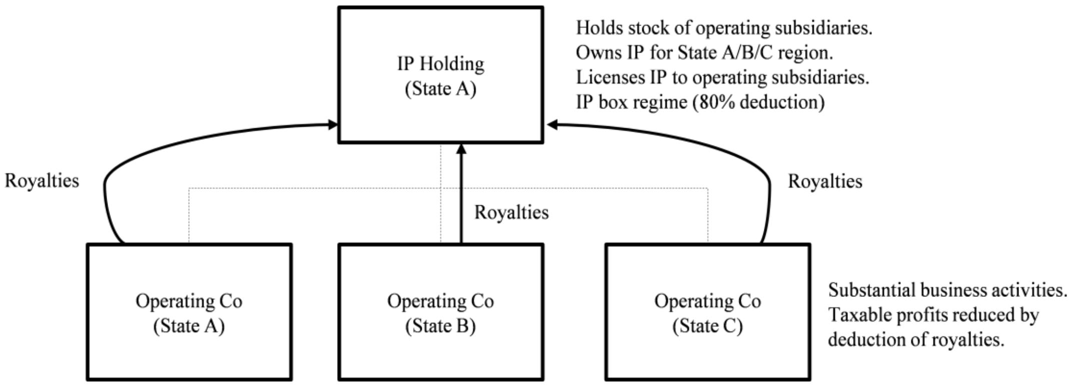
1. Implementation of the minimum standards

A regulatory framework for preferential tax regimes (Action 5)

321. As explained in Chapter 2, intangible assets are generally central to the value creation process of digital companies. In addition, intangibles and income arising from their exploitation are by definition geographically mobile. In this context, the desire to attract investment and offer a competitive tax environment has led a growing number of countries to introduce preferential tax treatments for income arising from the exploitation of intellectual property (IP). This is generally implemented through a 50% to 80% deduction or exemption of qualified IP income.

322. This creates an incentive for MNEs to locate their intangibles in tax jurisdictions where preferential regimes for IP income are available.[40] This incentive is generally increased by the ability to deduct the royalty payments for the use of the IP. The result is that the profits of affiliated entities carrying out substantial business activity can be significantly reduced, while minimal or no taxation is secured in the affiliate where the IP is located (Annex Figure 3.A.1).

Annex Figure 3.A.1. Scenario involving a preferential IP regime



323. The Action 5 minimum standard on preferential tax regimes to counter harmful tax practices is a key pillar of the BEPS package to tackle arrangements aimed at securing minimal or no taxation of returns from intangibles. To realign the location of taxable profits with the location of the underlying economic activity and value creation, a key part of the 2015 BEPS Action 5 Report requires that preferential tax regimes provide benefits only where the taxpayer is undertaking substantial activities. According to the nexus approach, tax benefits may be provided to income derived from IP assets only to the extent that the related, underlying research and development (R&D) activities are undertaken primarily by the taxpayer itself or in the tax jurisdiction providing the benefits.[41]

324. The impact of Action 5 is broad in its scope and affects all preferential regimes, well beyond IP regimes. Nonetheless, because of its focus on the digitalised economy, this chapter concentrates on IP regimes. In this context, there has already been significant progress. As set out in the 2017 Progress Report on Harmful Tax Practices (OECD, 2017[5]), with the exception of two countries, all OECD and G20 countries with IP regimes now comply with the "nexus approach" - a total of 19 out of 21 such regimes. Among new members of the Inclusive Framework on BEPS 31 IP regimes have been identified. Virtually all of these - 29 out of the 31 regimes – do not comply with the nexus approach and are being abolished or amended.[42]

Transparency of tax rulings (Action 5)

325. Tax rulings can play a useful role in providing certainty to taxpayers. Nonetheless, transparency in relation to rulings is critical to shed light on possible BEPS mismatches in different jurisdictions and consequently, to ensure a level playing field across different firms. For instance, some structures used by highly digitalised companies have involved the use of unilateral advance pricing arrangements (APAs) in one or multiple jurisdictions to create and exploit mismatches in the treatment of cross-border intra-group transactions for transfer pricing purposes.

326. To ensure greater transparency on how MNEs are taxed in some cross-border situations, one component of the transparency pillar of the BEPS minimum standards relates to the exchange of information on certain types of tax rulings. As part of Action 5, members of the Inclusive Framework have committed to the compulsory, spontaneous exchange of information on tax rulings that could present BEPS risks (Annex Figure 3.A.2). For the first time, information on rulings in key risk categories, including

certain rulings issued since January 2010 will be spontaneously exchanged with all relevant jurisdictions, subject to the necessary legal frameworks being in place.

327. All jurisdictions in the Inclusive Framework are investing significant resources to identify, prepare and begin exchanging information on rulings in line with the agreed framework. In some cases, jurisdictions have had to enact specific legislative and regulatory changes to allow spontaneous exchange of tax rulings. For the 28 EU Member States, a Directive for the exchange of information on rulings was adopted in 2015 (amended Directive 2011/16/EU on administrative cooperation in the field of taxation).

328. The first annual report on the peer review of the rulings transparency framework was released on 4 December 2017. By 31 December 2016, almost 10 000 relevant rulings had been identified and almost 6 500 have been exchanged between tax administrations around the world, providing authorities with useful information about potential risks to their own tax base. With additional and timelier information, the authorities will be able to also take action more efficiently against BEPS arrangements. This enhanced international co-operation may significantly impact taxpayers' behaviour, including that of highly digitalised companies.

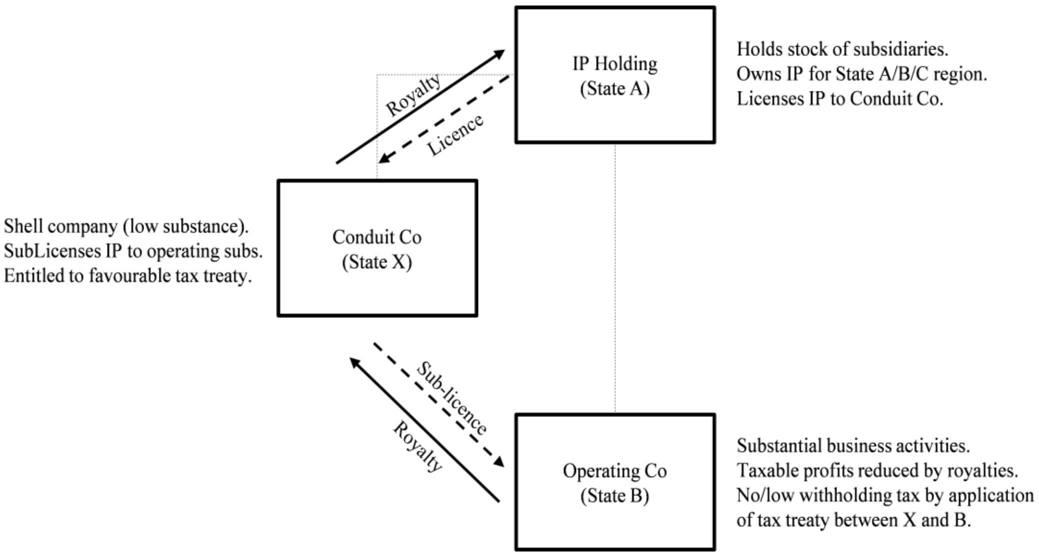
Annex Figure 3.A.2. Framework for tax rulings exchange

Scope of the compulsory spontaneous exchange of summaries of rulings	
Categories of rulings	**Jurisdictions receiving the information**
1. Taxpayer-specific rulings related to preferential regimes 2. Cross-border unilateral APAs and other cross-border unilateral tax rulings (such as ATRs) covering transfer pricing or the application of transfer pricing principles 3. Cross-border rulings providing for a unilateral downward adjustment to the taxpayer's taxable profits that is not directly reflected in the taxpayer's financial / commercial accounts 4. Permanent establishment rulings 5. Related party conduit rulings 6. Any other type of ruling that in the absence of spontaneous exchange gives rise to BEPS concerns (if and when agreed by the FHTP and IF)	1. For rulings 1 – 3: jurisdictions of residence of all related parties with which the taxpayer enters a transaction for which a ruling is granted or which gives rise to income from related parties benefiting from a preferential regime; and jurisdictions of residence of immediate parent company and ultimate parent company 2. For PE rulings, the head office or jurisdiction of the PE; and the jurisdictions of residence of immediate parent company and ultimate parent company 3. For conduit rulings, the jurisdiction of residence of any related party making payments to the conduit (directly or indirectly); and the jurisdiction of residence of the ultimate beneficial owner of payments made to the conduit; and the jurisdictions of residence of immediate parent company and ultimate parent company
Applies to both past rulings and new rulings	

Measures to prevent tax treaty abuse (Action 6)

329. Digitalised businesses are in many instances less reliant on local personnel and tangible assets to perform their activities. This increases the mobility of the global value chains of MNEs and makes it easier for some MNEs to choose the location of their key resources, such as intangible property assets[43], based on the tax rate levied in a specific jurisdiction. This implies that, through base eroding payments such as royalty payments, profits can be reduced substantially in affiliates where substantial business activity occurs (see Annex Figure 3.A.1). Withholding taxes generally apply on outbound payments such as royalties or interest. To reduce such taxes MNEs have sometimes used a conduit company located in a country with a favourable treaty network to obtain tax treaty benefits generally granted only to resident companies (treaty-shopping arrangements). As illustrated in Annex Figure 3.A.3, these tax strategies generally involve the conduit being interposed between the affiliates of an MNE group. The aim is to claim the benefits of a double tax treaty (between State X and State B) which is more favourable than the double tax treaty that would apply in the absence of the conduit company (the treaty between State A and State B).

Annex Figure 3.A.3. Scenario involving a treaty shopping arrangement



330. The BEPS package recognises that tax treaty abuse, and in particular treaty shopping, raises some of the most serious BEPS concerns. The minimum standard agreed under Action 6 includes anti-abuse provisions that countries have committed to include in their treaties.[44] In addition, the Action 6 minimum standard requires the inclusion of an explicit statement in the preamble of each treaty clarifying that the treaty is not intended to create opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements). These anti-abuse provisions and principles of interpretation will permit the denial of treaty benefits in circumstances in which the granting of benefits would not be in accordance with the object and purpose of the treaty. This will ensure that the source country can apply its domestic law in cases of avoidance, unconstrained by treaty rules aimed at preventing double taxation.

331. The Action 6 anti-abuse rules will apply broadly to address the treaty-shopping arrangements of highly digitalised businesses and the BEPS concerns. Their potential relevance for highly digitalised businesses can be illustrated by two examples. First, the principal purposes test (PPT) rule may be, in some cases, an effective response to a foreign company's artificial avoidance of PE status, especially when the relevant treaty has not been updated to include the modifications developed through the work on Action 7. Second, the PPT rule may be used to target situations in which there is indeed a taxable presence in the form of a PE or a group company, but the relevant taxable income is reduced by deductible, outgoing intra-group payments such as interest and/or royalties. Where such payments are artificially diverted through a shell or conduit company in a treaty jurisdiction (i.e., through a treaty-shopping arrangement) and the deductible payments are subject to a withholding tax under domestic law, the new PPT rule will allow the source country to apply its withholding tax without any treaty limitation.

332. Implementation of the Action 6 minimum standard has been widespread. Countries have started to implement the necessary treaty changes either through the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS (the Multilateral Instrument, or "MLI") or by updating their tax treaties through bilateral negotiations. To date, the tax treaties of 78 jurisdictions are covered by the MLI, which will ensure that more than 1,200 bilateral tax treaties reflect the Action 6 minimum

standard. Also, with additional jurisdictions continuing to join the MLI, this figure will increase.

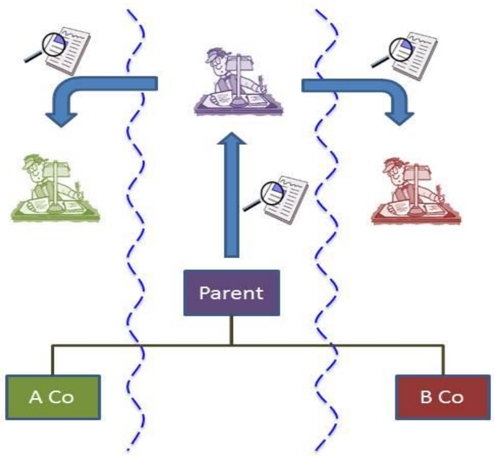
Transparency with Country-by-Country reporting (Action 13)

333. In the past, national tax administrations had limited information on where the profits of MNEs were located and how they were taxed in some foreign jurisdictions. A key component of the transparency pillar of the BEPS minimum standards is the obligation for all large MNEs to file Country-by-Country (CbC) reports (Action 13).[45] The CbC template was designed to support the risk-assessment capacities of tax administrations, particularly when used in conjunction with other sources of information such as the Master File and Local File which are part of the documentation package agreed under BEPS Action 13 (but not of the minimum standards). CbC reports will be important for the risk-assessment of digital businesses which, thanks to the highly intangible nature of their business, the resulting mobility of their profits and their integrated global value chains, have a greater ability to artificially concentrate large parts of their taxable income in low or no tax jurisdictions where no or limited economic activities take place.

334. Most Inclusive Framework jurisdictions have now implemented legislation for CbC reporting and legislation is in place for around 95% of the MNEs expected to be affected by CbC reporting requirements.[46] The first CbC reports have now been filed (i.e., by the end of 2017) and will be exchanged by June 2018. From that date, tax administrations will be able to better understand MNEs' global operations. Consequently, they will be better placed to assess the tax risks involved, allowing more targeted and effective use of their resources.

335. As well as putting in place the domestic legal framework to require CbCR[47], jurisdictions have also moved quickly to ensure that CbCRs will be automatically exchanged between tax administrations (Annex Figure 3.A.4). The exchanges will be carried out on a confidential basis and pursuant to an appropriate international instrument being the Multilateral Convention on Mutual Administrative Assistance in Tax Matters, a double tax convention (DTC) or a tax information exchange agreement (TIEA). To date, 68 jurisdictions[48] have signed the Multilateral Competent Authority Agreement (the CbC MCAA), which is designed to operationalise the exchange of CbC Reports between jurisdictions that are parties to the Multilateral Convention on Mutual Administrative Assistance on Tax Matters. As of January 2018, over 1400 bilateral exchange relationships have been activated under the CbC MCAA with respect to jurisdictions committed to exchanging CbC reports. Some bilateral Competent Authority Agreements have also been signed, where jurisdictions intend to exchange CbC Reports under a DTC or TIEA.[49]

Annex Figure 3.A.4. Filing and exchange of country-by-country reports



2. Implementation of domestic measures to tackle BEPS in the context of digitalisation

336. The BEPS package also recommended the coordinated implementation of a number of measures requiring domestic law changes. These measures were presented as agreed common approaches with regards to limiting excessive interest deductibility (Action 4) and neutralising hybrid mismatches (Action 2). Other measures constitute guidance based on best practices for jurisdictions intending to limit BEPS through controlled foreign company (CFC) rules (Action 3) and increase transparency through mandatory disclosure rules (Action 12). Excessive interest deductions, hybrid instruments, hybrid entities, and the diversion of income to low-taxed subsidiaries without substance have long been widely used in aggressive tax planning. Given that progress in the implementation of CFC rules has already been described in Chapter 3, this section is focused on other domestic measures implemented by countries.

337. Action 2 of the BEPS package provides a number of relevant recommendations[50] tackling the design of domestic rules and the development of tax treaty provisions to neutralise the effect of hybrid instruments and entities. The work of Action 4 is also important in the context of highly digitalised businesses. It resulted in an agreed framework for best practices aimed at reducing opportunities for BEPS via interest and other deductible financial payments. Finally, another important component of the overall package is the 2015 BEPS Report on Action 12, which includes an overview of mandatory disclosure regimes[51] and sets out recommendations for a framework for countries wishing to implement or amend mandatory disclosure rules to obtain early information on aggressive or abusive tax planning schemes and their users. Taken together, these measures will make it more difficult for MNEs to engage in aggressive tax planning as they will allow countries to identify and respond to these schemes in a timely manner.

338. Many countries have begun implementing the recommendations on domestic tax measures to neutralise the effect of hybrid instruments and entities. The EU Council's Anti-Tax Avoidance Directive 2016/1164/EU (ATAD1),[52] amended by the Directive 2017/952/EU (ATAD2),[53] requires all 28 EU Member States to introduce rules based on Action 2 (hybrid mismatches) by 31 December 2019.[54] Some EU Member States have already implemented those provisions in their domestic law.[55] Similarly, the United States recently adopted - as part of the Tax Cuts and Jobs Act (TCJA) - anti-hybrid provisions (hybrid mismatches) in accordance with the recommendations outlined in Action 2.[56] There are a further six countries (Japan, Liechtenstein, Korea, Mexico, Norway and South Africa) that have already partially adopted the Action 2 recommendations into their domestic law, and a number of others are actively reviewing their rules with a view to considering full implementation of the Action 2 measures into their domestic law (e.g., Australia, Malaysia and New Zealand). In total, there are more than 35 countries that have (or will shortly have) the Action 2 hybrid mismatch and branch mismatch rules, or elements of these rules, in their domestic legislation.

339. Recommendations under Action 4 (interest deductibility) have also seen increasing interest from countries. EU Member States have committed under ATAD1 to translate into their domestic law provisions that limit the amount of intra-group net interest that a company can deduct from its taxable income based on a fixed ratio of its earnings (earnings before interest, tax depreciation and amortisation (EBITDA)).[57] The United States introduced a similar limitation on the deductibility of interest in excess of 30% of a business's adjusted taxable income (similar to EBITDA). Various other countries have either already taken similar legislative steps (e.g., Argentina, India, South Korea, South Africa, Viet Nam), or are in the process of aligning their domestic legislation with the recommendations of Action 4 (e.g., Norway, Japan, Malaysia, and Turkey).

340. The guidance related to mandatory disclosure rules (Action 12) is also being considered by a number of countries. In addition to countries that already have mandatory disclosure rules targeted at aggressive tax planning arrangements (e.g., Canada, Ireland, Israel, Mexico, Portugal, South Africa, the United Kingdom and the United States), the EU Commission has recently submitted proposed legislation drawing on some of the best practices contained in the 2015 BEPS Action 12 Report,[58] and other countries have started internal reviews and public consultation processes (e.g., Australia, Japan, Poland and Sweden).

Annex 3.B. Implementation of the Measures on VAT/GST covered by the 2015 BEPS Action 1 Report[1]

Annex Table 3.B.1. Implementation of the Measures on VAT/GST covered by the BEPS Action 1 Report

Jurisdiction	Implementation of the B2C Guidelines[2]	Implementation of simplified registration and compliance regimes[3]	Implementation of mechanisms for collecting VAT/GST on the importation of low-value goods from online trade	Available data on the impact of implementation of the recommended solutions and available option[4]
Albania	Yes (as of January 1, 2015)	No (standard registration applies)	No	Not available
Andorra	Yes (as of January 2013)	No (standard registration applies)	No	Not available
Argentina	Yes (as of February 1, 2018)	No (withholding mechanism will apply)	No	-
Australia	Yes (as of July 1, 2017)	Yes	Yes (as of July 1, 2018)	Not available
Austria	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Bahamas	Yes (as of January 1, 2015)	No (standard registration applies)	No	Not available
Belarus	Yes (as of January 1, 2018)	Yes	No	Not available
Belgium	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	VAT revenue collected increased from EUR 1.5 mln (3rd quarter of 2015) to EUR 2.0 mln (2nd quarter of 2016)
Bulgaria	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	Net effect of the MOSS operation in 2016: EUR 5.1 mln
Canada	Yes (as of January 1, 1991)	No (self-assessment mechanism by customer applies)	No	Not available
China	Yes (as of 2009)	No (withholding mechanism applies)	No	Not available
Colombia	Yes (as of January 1, 2018)	No (withholding mechanism applies)	No	Not available

Jurisdiction	Implementation of the B2C Guidelines[2]	Implementation of simplified registration and compliance regimes[3]	Implementation of mechanisms for collecting VAT/GST on the importation of low-value goods from online trade	Available data on the impact of implementation of the recommended solutions and available option[4]
Costa Rica	Under consideration	Under consideration (withholding mechanism under consideration)	No	N/A
Croatia	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Czech Republic	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Denmark	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Estonia	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Finland	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
France	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Ghana	Yes (as of 2013)	No (standard registration applies)	No	Not available
Germany	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Greece	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Hungary	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Iceland	Yes (as of November 1, 2011)	No (standard registration applies)	No	Not available
India	Yes (as of July 1, 2017)	Yes	No	Not available
Indonesia	Under consideration	N/A	No	N/A
Ireland	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Israel	Under consideration	N/A	No	N/A
Italy	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Japan	Yes (as of October 1, 2015)	No (standard registration applies)	No	Not available

Jurisdiction	Implementation of the B2C Guidelines[2]	Implementation of simplified registration and compliance regimes[3]	Implementation of mechanisms for collecting VAT/GST on the importation of low-value goods from online trade	Available data on the impact of implementation of the recommended solutions and available option[4]
Kenya	Yes (as of September 2, 2013)	No (standard registration applies)	No	Not available
Korea	Yes (as of July 1, 2015)	Yes	No	Not available
Latvia	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study5
Lithuania	Yes (as of July 1, 2002)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study5
Luxembourg	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study5
Malaysia	Under consideration	N/A	No	N/A
Malta	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study5
Mexico	Yes (as of 1980)	No (self-assessment mechanism by customer applies)	No	Not available
Netherlands	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study5
New Zealand	Yes (as of October 1, 2016)	Yes	No	Not available
Norway	Yes (as of July 1, 2011)	Yes	No	Not available
Poland	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study5
Portugal	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study5
Romania	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study5
Russia	Yes (as of January 1, 2017)	Yes	No	Not available
Saudi Arabia	Yes (as of January 1, 2018)	No (standard registration applies)	No	N/A
Serbia	Yes (as of January 1, 2017)	No (standard registration applies)	No	Not available
Singapore	Yes[59]	Yes[60]	Under consideration	Not applicable

Jurisdiction	Implementation of the B2C Guidelines[2]	Implementation of simplified registration and compliance regimes[3]	Implementation of mechanisms for collecting VAT/GST on the importation of low-value goods from online trade	Available data on the impact of implementation of the recommended solutions and available option[4]
Slovak Republic	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Slovenia	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
South Africa	Yes (as of June 1, 2014)	Yes	No	Data for 2016/2017: 223 registrations as e-commerce vendors; Revenue of ZAR 585 mln generated.
Spain	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Sweden	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]
Switzerland	Yes (as of 2010)	No (standard registration applies)	Under consideration	Not available
Tanzania	Yes (as of July 1, 2015)	No (standard registration applies)	No	Not available
Thailand	Under consideration	Under consideration (withholding mechanism under consideration)	No	N/A
The Philippines	Under consideration	N/A	No	N/A
Tunisia	Under consideration	N/A	No	N/A
Turkey	Yes (as of January 1, 2018)	Yes (in progress)	No	Not available
United Kingdom	Yes (as of January 1, 2015)	Yes	Under consideration at EU Level	See data available for all EU countries in the November 2016 assessment study[5]

1. This table includes countries that operate a VAT/GST system and have implemented the solutions and available options provided in the International VAT/GST Guidelines or that are considering doing so, according to the information currently available.
2. Implementation of the approaches recommended by the International VAT/GST Guidelines for the application of the destination principle to remote digital supplies to consumers (B2C).
3. Implementation of mechanisms based on simplified registration and compliance regimes for the effective collection of VAT/GST on inbound B2C supplies. Simplified registration and compliance regime operates separately from the traditional (standard) registration and compliance regime, without the same rights (e.g., input tax recovery) and obligations (e.g., full reporting) as a traditional regime. See OECD (2017), International VAT/GST Guidelines, Chapter 3, C.3.2.
4. Recommendations and options to address the VAT/GST challenges of the digital economy.

5. The EU has identified the total VAT revenue declared via its simplified compliance regime (MOSS) in its first year of operation (2015) as in excess of EUR 3 billion. Approximately, 70% of the total cross-border B2C supplies of services and intangibles that are in scope of this regime are captured by this simplified compliance regime. Moreover the availability of MOSS allowed businesses that adopted it to achieve a notable reduction of the compliance burden, which according to estimates, is 95% lower than what it would have been without such simplification measure (i.e., the MOSS allowed businesses using it to save about EUR 500 million in compliance costs). Source: Deloitte study on the "VAT Aspects of cross-border e-commerce – Options for modernisation Final report – Lot 3 – Assessment of the implementation of the 2015 place of supply rules and the Mini-One Stop Shop" (November 2016) available at the European Commission's website (https://ec.europa.eu/taxation_customs/sites/taxation/files/vat_aspects_cross-border_e-commerce_final_report_lot3.pdf).

Notes

[1] The salient characteristics of highly digitalised businesses are also outlined in Chapter 2 on Digitalisation, Business Models and Value Creation. These frequently observed characteristics include: cross-jurisdictional scale without mass; reliance on intangible assets, including intellectual property (IP); and data, user participation and their synergies with IP.

[2] For ease of reading, the terms "value added tax" and "VAT" are used to refer to any national tax by whatever name or acronym it is known, such as Goods and Services Tax (GST), which embodies the basic features of a value added tax i.e., a broad-based tax on final consumption collected from but in principle not borne by businesses through a staged collection process whatever method is used for determining the tax liability (e.g., invoice-credit method or subtraction method).

[3] The broader direct tax challenges raised by digitalisation were described in detail in Chapter 7 of the 2015 BEPS Action 1 Report. These challenges are also further described in this report in Chapter 5 on Adapting the International Tax System to the Digitalisation of the Economy.

[4] Important information on how companies have responded to the BEPS measures will also become available from Country-by-Country Reports (CbCR), which have been filed by the end of 2017 and will be exchanged in June 2018. As a result of the BEPS Action 11 Report (OECD, 2015[8]), countries are currently working towards an agreed approach to making anonymised and aggregated CbCR data available through the OECD, although these data are not expected to be released until 2019. In addition, new data sources such as those on special purpose entities and foreign direct investment by immediate and ultimate country of investment is becoming available for some countries, which will also support further analysis of the use of intermediary structures such as conduit companies.

[5] See among others, the press release from Facebook in December 2017 announcing a shift to local selling structures in countries where it has an office to support sales to local advertisers (Wehner, 2017[9]). This impact is further discussed below in paragraphs 309 and 310.

[6] This impact is further discussed below in paragraph 308.

[7] A "commissionnaire arrangement" may be loosely defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission).

[8] Separately, Action 7 (OECD, 2015[10]) also recommended complementing Article 5(4) with a specific anti-abuse rule to prevent MNE groups from fragmenting their operations in a country

(between separate locations and/or closely related enterprises) in order to inappropriately take advantage of the exemptions from permanent establishment status provided by Article 5(4).

9 See (OECD, 2017[11]).

10 These estimates were made on 24 January 2018 based on information taken from the "MLI Database - Matrix of options and reservations" (OECD, 2017[12])

11 The final Action 7 Report mandated the development of additional guidance on how the rules of Article 7 of the OECD Model Tax Convention would apply to PEs resulting from the changes in the Report, in particular for PEs outside the financial sector. A revised discussion draft containing additional guidance on the attribution of profits to permanent establishments was released on 22 June 2017 (OECD, 2017[18]) and discussed at the 6-7 November 2017 public consultation on transfer pricing matters. Final approval of guidance is expected on 12 February 2018.

12 E-bay reported to their customers in a number of countries that they changed the contracting party from a foreign to a domestic company (eBay Canada Limited, 2017[13]; eBay Inc, 2017[14]). Similar developments concerning Amazon in European Union countries were reported in the press (Scott, 2015[16]; Zeit Online, 2015[15]). More recently, Facebook announced its decision to move to a local selling structure in countries where they have an office to support sales to local advertisers (Wehner, 2017[9]; Johnston, 2017[17]). Similar developments concerning Google in New Zealand were reported in the press (Johnston, 2018[28]). This impact is further discussed below in paragraphs 309 and 310.

13 The United Nations (UN) Committee of Experts on International Cooperation in Tax Matters has adopted changes to the UN Model Double Taxation Convention incorporating the key tax treaty recommendations of the BEPS package, including the Action 7 recommendations with respect to the PE definition, as well as the minimum standard on tax treaty abuse under Action 6. The broad adoption of the tax treaty related BEPS recommendations by the UN Committee of Experts demonstrates the broad support for the tax treaty related recommendations developed in the BEPS Project, and will further support the swift and consistent adoption of these BEPS recommendations globally.

14 (EU Council, 2016[29]).

15 The European Commission has, under its proposal for a Council Directive on a Common Corporate Tax Base (CCTB), proposed to take a step further to tighten the CFC-rules in EU countries. The proposal states that the substance carve-out rule should only be applicable to a controlled foreign company that is resident or situated in a Member State or in a third country that is party to the EEA agreement. The exception will thereby not be available to controlled foreign companies in third countries, and will significantly tighten the CFC-taxation towards these countries. Further, the alternative method of a standalone substance test from the Anti-Tax Avoidance Directive (2016/1164/EU) point (b) of article 7(2) has been discarded in the proposed CCTB directive. Accordingly, it would no longer be possible for EU countries to limit the CFC-taxation to capture income "arising from non-genuine arrangements, which have been put in place for the essential purpose of obtaining a tax advantage."

16 Public Law No. 115-97, 22 December 2017, Section 14201 (a) introducing sec. 951A in Subpart F of part III of subchapter N of chapter 1 of the Internal Revenue Code of 1986 (US Congress, 2017[19]).

17 The combined effective rate of 13.125% applies in situations where the US taxpayer is entitled to foreign tax credits. In cases where the US taxpayer is not entitled to foreign tax credits (e.g., CFC in a jurisdiction with no corporate tax), the effective corporate tax rate can be reduced to as low as 10.5%.

[18] Article 66-6 to 66-9 of Act on Special Measures concerning Taxation; Articles 39-14 to 39-20 of Order for Enforcement of the Act on Special Measures concerning Taxation.

[19] Countries have some flexibility to meet this commitment and should include in their tax treaties either (i) the combined approach of the limitation-on-benefits clause (LOB rule) and a more general anti-abuse rule based on the principal purposes of transactions or arrangements (PPT rule), (ii) the PPT rule alone, (iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

[20] The 2015 BEPS Action 5 Report specified that jurisdictions that are not EU Member States could allow the inclusion of all qualifying R&D expenditures undertaken by related parties in the definition of qualifying expenditures provided that those related parties are resident in the jurisdiction granting the tax benefit (see footnote 16 of Chapter IV of the Report, (OECD, 2015[35])).

[21] The OECD International VAT/GST Guidelines set forth a number of principles for the VAT treatment of the most common types of international transactions, focusing on trade in services and intangibles, with aim of reducing uncertainty and risks of double taxation and unintended non-taxation that result from inconsistencies in the application of VAT in a cross-border context. They build on international dialogue among OECD Members and Partners and other relevant stakeholders. They have been incorporated in the OECD Council Recommendation on the Application of Value Added Tax/Goods and Services Tax to the International Trade in Services and Intangibles. This Council Recommendation is the first OECD legal instrument in the area of VAT and the first internationally agreed framework for the application of VAT to cross-border trade which aspires to a global coverage.

[22] Specifically, the implementation of Guidelines 3.2 and 3.4 of the Guidelines will minimise BEPS opportunities for supplies of remotely delivered services and intangibles made to exempt businesses, including exempt entities that operate through establishments (branches) in multiple jurisdictions (multiple location entities). Guideline 3.2 recommends that the taxing rights on cross-border supplies of services and intangibles between businesses be allocated to the jurisdiction where the customer has located its business establishment and that business customers be required to self-assess VAT on remotely delivered services or intangibles acquired from offshore suppliers according to the rules of the jurisdiction in which they are located. Guideline 3.4 provides that when a supply is made to a business that is established in more than one jurisdiction, taxation should accrue to the jurisdiction where the customer's establishment (branch) using the service or intangible is located.

[23] Singapore has announced the introduction of taxation of B2C cross-border supplies of digital services with implementation on January 1, 2020, subject to the passing of legislation in Parliament.

[24] See (Deloitte, 2016[6]).

[25] See (Deloitte, 2016[6]).

[26] The report was developed with the active involvement of both a broad range of jurisdictions beyond the OECD and the global business community, notably through the OECD Global Forum on VAT and the Technical Advisory Group to OECD Working Party No. 9 on Consumption Taxes (WP9 TAG) (OECD, 2017[21]). It provides a general description of basic policy questions and design issues concerning the collection of VAT on supplies of services and intangibles by foreign suppliers together with an overview of key policy and design issues for tax authorities to consider when designing and implementing a registration-based collection regime with or without simplification measures. It also provides more detailed guidance on the design and practical operation of a simplified registration and collection regime as recommended by the VAT/GST Guidelines and by the 2015 BEPS Action 1 Report. It does not aim at detailed prescriptions for

national legislation. Jurisdictions are sovereign with respect to the design and application of their laws. Rather, the report seeks to present a range of possible approaches and discuss associated policy considerations. The report is evolutionary in nature and will be reviewed regularly in light of the rapid development of technology and online sales and delivery processes.

[27] These include: The Multilateral Convention on Mutual Administrative Assistance in Tax Matters; the OECD Model Tax Convention Article 26 (Information Exchange); and the OECD Model Agreement on Exchange of Information.

[28] Developments in jurisdictions that have implemented collection mechanisms through platforms (or that are introducing such measures) and work carried out in other international fora, can inform complement one another through ongoing information sharing.

[29] The 2015 BEPS Action 5 Report specified that jurisdictions that are not EU Member States could allow the inclusion of all qualifying R&D expenditures undertaken by related parties in the definition of qualifying expenditures provided that those related parties are resident in the jurisdiction granting the tax benefit (see footnote 16 of Chapter IV of the Report, (OECD, 2015[35])).

[30] A Thomson Reuters survey of tax directors found "66% proactively taking steps based on the BEPS recommendations; 22% waiting for countries to implement, 7% waiting for all action points in the project to be finalized before you act; 3% waiting for peers to make a move, and 3% not doing anything at all." (Reuters, 2016[32]). See also (KPMG, 2016[33]); (Deloitte, 2017[34]).

[31] For example, in a report presented to the Irish Minister for Finance and Public Expenditure and Reform (Coffey, 2017[22]), relevant data is provided indicating that "*Ireland's national accounts have been impacted by a number of intangible on-shoring events in recent years with the profit generated by these intangible assets now included in gross measures of Ireland's national income. Most notably there was an increase in the stock of intangible assets in Ireland of around €250 billion in Q1 2015 while the Quarterly National Accounts for Q4 2016 show investment in the acquisition of intangibles of around €25 billion*". The same report further specifies that "*In nominal terms Ireland's gross capital stock rose from €756 billion to €1,088 billion, an increase of €332 billion. Changes in the capital stock are usually driven by investment (either outright purchase or internal development) and obsolescence (withdrawal from use) giving entries and exits to the capital stock. However, in 2015 investment in capital was €54.1 billion. Thus nearly 85 per cent of the €332 billion increase in the capital stock cannot be explained by investment. Table 9.8 gives the composition of Ireland's gross capital stock for 2014 and 2015. In the 2015 data, two categories have been suppressed for confidentiality reasons; transport equipment and research and development. The categories reflect aircraft leasing and the on-shoring of intellectual property assets. The categories for which data is provided recorded an increase of €42 billion in 2015 so the remaining €289 billion is accounted for by the missing categories of transport equipment and intangibles. It is probable that the bulk of this was due to intangibles.*"

[32] E-bay reported to their customers in a number of countries that they changed the contracting party from a foreign to a domestic company (eBay Canada Limited, 2017[13]) (eBay Inc, 2017[14]). Similar developments concerning Amazon in European Union countries were reported in the press (Scott, 2015[16]) (Zeit Online, 2015[15]). More recently, Facebook announced its decision to move to a local selling structure in countries where they have an office to support sales to local advertisers (Wehner, 2017[9]). Similar developments concerning Google in New Zealand were reported in the press (Johnston, 2018[28]).

[33] The term "buy-sell distributor" refers to a reseller who takes title to the goods being sold to local customers. This creates a local point of revenue recognition, as the sales revenue generated by transactions with local customers will be reported in that entity's local financial statements and tax return. A "buy-sell distributor" typically bears the risks associated with buying, holding and selling the products. While such reseller models are commonly used for the distribution of goods, they are

less common for the provision of services, especially in countries where commercial law does not enable the resale of services. Further, it should be noted that such local sales structures can be inefficient for enterprises that are potentially able to centralise functions at a regional and/or global level to gain substantial economies of scale with respect to certain functions related to an MNE's sales activities (e.g., infrastructure, customer relationship management, invoicing process).

[34] See (Deloitte, 2016[6]).

[35] As part of the BEPS package, Members of the Inclusive Framework have committed to implement the four minimum standards in the areas of fighting harmful tax practices (Action 5), preventing treaty shopping (Action 6), implementing Country-by-Country Reporting (Action 13), and improving dispute resolution (Action 14). These minimum standards are subject to a rigorous monitoring process (i.e., so-called peer-review).

[36] The mandate of the Inclusive Framework supports international cooperation in four areas: (i) review the implementation of the four BEPS minimum standards; (ii) gather data for the monitoring of the other aspects of implementation, including under BEPS Actions 1 (on the tax challenges of the digital economy) and 11 (on measuring and monitoring BEPS); (iii) finalise the remaining technical work to address BEPS challenges; and (iv) support jurisdictions in their implementation of the BEPS package, including by providing further guidance on the standards and by developing toolkits for low income countries.

[37] Following the delivery of the BEPS package, it was agreed that the Inclusive Framework on BEPS would continue the technical work on some BEPS standards which require further development. These include finalising transfer pricing guidance on the application of transactional profit split methods and on financial transactions and discussing the rules for the attribution of profits to permanent establishments in light of the changes to the permanent establishment definition.

[38] To ensure widespread and efficient implementation, peer reviews will also be undertaken for "jurisdictions of relevance" – jurisdictions that are not members of the Inclusive Framework but whose implementation of a particular minimum standard will be necessary to ensure an effective reduction in BEPS behaviours. The peer reviews are based on terms of reference and a specific methodology for each standard. Further information about the terms of reference and methodology for the peer reviews of the minimum standards, including their schedules for each minimum standard, can be found in Annex C of the OECD report "Inclusive Framework on BEPS: Progress Report", published on 5 July 2017.

[39] Action 14 is a key pillar of the BEPS Project as it provides effective tools to reduce double taxation but does not strictly relate to the exercise undertaken in this report. Under Action 14, a minimum standard was established to improve the effectiveness of dispute resolution mechanisms, including through dispute prevention, availability and access to the treaty mutual agreement procedures (MAP), resolution of MAP cases and implementation of MAP agreements. All of the treaty-related elements of the Action 14 minimum standard may be implemented by joining the MLI (Box 3.1). To date, the MLI covers 78 jurisdictions.

[40] Note that this paragraph is focused on the BEPS issues associated with preferential regimes, and does not discuss the BEPS issues that may arise from the transfer of intangible property between affiliated entities for transfer pricing purposes, or from the pricing of the intra-group royalty payment in accordance with the arm's length principle.

[41] The 2015 BEPS Action 5 Report specified that jurisdictions that are not EU Member States could allow the inclusion of all qualifying R&D expenditures undertaken by related parties in the definition of qualifying expenditures provided that those related parties are resident in the jurisdiction granting the tax benefit (see footnote 16 of Chapter IV of the Report, (OECD, 2015[35])).

[42] The 2015 BEPS Action 5 Report sets out the requirements for closing off regimes and grandfathering of existing members of the Forum on Harmful Tax Practices: no new entrants in existing non-nexus consistent IP regimes are allowed after 30 June 2016 and grandfathering is allowed for a maximum of five years (30 June 2021). For new Inclusive Framework members, the cut-off date for new entrants is 30 June 2018 and grandfathering is allowed up until 30 June 2021.

[43] The following paragraphs are focused on the BEPS issues associated with treaty shopping arrangements, and do not discuss the BEPS issues that may arise from the transfer of intangible property assets between affiliated entities for transfer pricing purposes, or from the pricing of the intra-group royalty payment in accordance with the arm's length principle.

[44] Countries have some flexibility to meet this commitment and should include in their tax treaties either (i) the combined approach of the limitation-on-benefits (LOB) rule and a more general anti-abuse rule based on the principal purposes of transactions or arrangements (PPT rule), (ii) the PPT rule alone, (iii) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

[45] A key step towards implementation is to establish the necessary domestic legal framework to require CbCR. More than 60 jurisdictions have already implemented an obligation for relevant MNEs to file CbCRs, of which more than 45 have completed all necessary domestic processes and have the full legal framework in place. Jurisdictions that have initiated the implementation process already include all 35 OECD Members, 7 non-OECD G20 countries (Argentina, Brazil, India, Indonesia, People's Republic of China, the Russian Federation and South Africa), as well as 24 other jurisdictions (Bermuda, Cayman Islands, Colombia, Côte d'Ivoire, Egypt, Gabon, Guernsey, Hong Kong, Isle of Man, Jersey, Kenya, Liechtenstein, Malaysia, Malta, Mauritius, Monaco, Nigeria, Pakistan, Peru, Qatar, Senegal, Singapore, Uruguay and Vietnam). For the 28 EU Member States, the obligation to implement CbCR is now enshrined in a binding Directive (Council Directive 2016/881/EU). In addition, Master and Local File requirements are implemented or in the process of being in implemented by approximately 40 jurisdictions.

[46] An up to date list of the jurisdictions that have signed the CbC MCAA is available at: www.oecd.org/tax/automatic-exchange/about-automatic-exchange/CbC-MCAA-Signatories.pdf.

[47] The first annual peer review process of the implementation of CbC Reporting which includes all members of the Inclusive Framework commenced in February 2017. Where the peer review process reveals questions concerning the interpretation or operation of the Action 13 minimum standard, these may be dealt with through guidance or be fed into discussions on the review of the minimum standard in 2020.

[48] Multilateral Convention on Mutual Administrative Assistance on Tax Matters: www.oecd.org/ctp/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm. Since the delivery of the BEPS package in October 2015, **25** countries have joined the Convention: Bahamas, Bahrain, Brunei Darussalam, Burkina Faso, Cook Islands, Dominican Republic, Israel, Jamaica, Kenya, Kuwait, Lebanon, Malaysia, Marshall Islands, Nauru, Niue, Pakistan, Panama, Peru, Qatar, Saint Kitts and Nevis, Saint Lucia, Saint Vincent and the Grenadines, Samoa, Senegal, Uganda, United Arab Emirates, and Uruguay. Today, there are 117 jurisdictions participating in the Convention.

[49] The first annual peer review process of the implementation of CbC Reporting which includes all members of the Inclusive Framework commenced in February 2017. Jurisdictions that have joined the Inclusive Framework later than February 2017 have not necessarily been able to participate in this first annual peer review process. It is expected that they will be included in the following annual peer review process starting in 2018. Where the peer review process reveals questions concerning the interpretation or operation of the Action 13 minimum standard, these may be dealt with through guidance or be fed into discussions on the review of the minimum standard in 2020.

[50] The report also includes detailed commentary explaining how the recommendations are intended to operate in practice.

[51] Mandatory disclosure regimes differ from other disclosure and compliance initiatives commonly used by countries (e.g., rulings, voluntary disclosure, co-operative compliance programmes) in that they are specifically designed to require taxpayers and promoters to provide tax administrations with early disclosure of potentially aggressive or abusive tax planning arrangements if they fall within the definition of a reportable scheme set out under that regime.

[52] (EU Council, 2016[29]).

[53] (EU Council, 2017[31])

[54] The initial provisions regarding hybrid mismatches between EU Member States in ATAD1 have been extended by ATAD2 to cover more categories of mismatches as well as arrangements involving third countries. Today, the Directive addresses mismatch situations resulting from double deduction, deduction without inclusion, characterisation conflicts of financial instruments, payments and entities and from the allocation of payments. Furthermore, it captures situations involving disregarded permanent establishments and tax residence mismatches. The preamble of ATAD2 explicitly refers to Action 2 as "*a source of illustration or interpretation to the extent that they are consistent with the provisions of the Directive and with Union law*".

[55] The United Kingdom is among the first EU member states that implemented new anti-hybrid rules in accordance with ATAD1 and ATAD2. These new rules became effective on 1 January 2017 (HM Revenue and Customs, 2016[23]; Sheppard, 2017[24]).

[56] The legislation introduces two mechanisms to implement the recommendations of Action 2. The first one (Section 245A(e) of the Internal Revenue Code) disallows the dividend exemption for "hybrid dividends" – that is, a payment for which the payer receives a deduction (or other tax benefit) for the payment in the payer jurisdiction. The second one (Section 267A of the Internal Revenue Code) limits the deductibility of intra-group payments on hybrid instruments or to hybrid entities – that is, a payment which is not included in the income of the payee under the laws of its country of residence, or the payee is allowed a deduction offsetting that income under such laws (Wagam, Catalano and Kravitz, 2018[27]; US Congress, 2017[19]).

[57] The legislation (The Council of the European Union, 2016[25]) includes in Article 4 (4) a grandfathering rule, which means debt in place prior to 17 June 2016 will be excluded from the scope of the interest limitation rule, as will interest used to fund long-term public infrastructure projects. EU Member States which have equivalent rules will be allowed to continue with those rules until the OECD recommends a minimum standard of interest limitation rules or at the latest by 1 January 2024.

[58] Under the current proposal, the new reporting requirements would enter into force on 1 January 2019 (European Commission, 2017[26]), but the starting date of application is still under discussion.

[59] Singapore has announced the introduction of taxation of B2C cross-border supplies of digital services with implementation on January 1, 2020, subject to the passing of legislation in Parliament.

[60] Singapore has announced the introduction of taxation of B2C cross-border supplies of digital services with implementation on January 1, 2020, subject to the passing of legislation in Parliament.

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