PART 2 OF A REPORT TO G20 DEVELOPMENT WORKING GROUP ON THE IMPACT OF BEPS IN LOW INCOME COUNTRIES

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OECD
BETTER POLICIES FOR BETTER LIVES

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EXECUTIVE SUMMARY

This paper constitutes Part 2 of a two-part report to the G20 Development Working Group (DWG) on the impact of BEPS in low income countries. It builds on Part 1 of the report, which was presented to the DWG at its meeting in Hobart in May 2014[1].

The DWG has invited the Organisation for Economic Co-operation and Development (OECD) to write a report on the main challenges of BEPS in developing countries, how these are related to the Action Plan, and how the DWG might assist developing countries to meet those challenges. This report draws on the experiences of developing countries and the report reflects comments from the International Monetary Fund (IMF), given its body of work on international tax issues, with a particular focus on the special concerns and experiences of developing countries, and from the World Bank Group (WBG), United Nations (UN) and regional organisations[2].

The report is not intended to provide, and does not represent, a consensus view shared by these organisations.

The report identifies the highest priority BEPS issues faced by developing countries and sets out how the DWG could help. This means that the report is restricted to a discussion of issues, including capacity development concerns, that arise from the interaction between different tax rules or from arrangements that lead to no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. It should be recognised that this is only one of many challenges faced by developing countries as evidenced by the work of international organisations.

The 2011 report from the international organisations to the DWG (OECD, 2011) noted that a series of broader problems plague the revenue raising efforts of developing countries including corruption, the informal sector and various tax policy and administration concerns. This diagnosis remains true today and BEPS must be seen in the context of a range of priorities that each country faces. Nevertheless, for many developing countries, addressing BEPS is not a luxury item – one that can be delayed to when more advanced levels of development are reached. Reliance on corporation tax means addressing BEPS is an urgent domestic resource mobilisation matter – a bridge that must be crossed in lower and middle income countries, in combination with other pressing problems – and a strengthened capacity to address BEPS issues in turn strengthens effectiveness in other areas, including domestic tax avoidance.

The report outlines a number of recommendations on how the DWG can assist developing countries meet the challenges posed by BEPS, particularly the priorities identified in the Action Plan. The key messages and recommendations are as follows:

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[1] The report is prepared under the responsibility of the OECD Secretariat. It does not represent the views of member states.

[2] The DWG's Terms of Reference state: "the report will be led by the OECD Tax and Development Secretariat, drawing on the views and expertise of the OECD Centre for Tax Policy and Administration (CTPA). … The OECD Tax and Development Secretariat will work closely with and coordinate its work with the IMF, in order to benefit from the IMF's near-universal membership and expertise in domestic resource mobilisation in developing countries. … The Tax and Development Secretariat will also work with other international and regional organisations to elicit the views of LICs."

- BEPS is an issue which harms developed and developing countries, arising from deficiencies of current international tax rules and standards. As a standard setter, the OECD is engaged in fixing these deficiencies involving all G20 countries on an equal footing. While it is recognised that no one size fits all, global solutions are needed to resolve global problems. It is essential that the OECD take the views and perspectives of developing countries into account when developing a new international tax framework.

- The OECD/G20 BEPS Project, which is responsible for the Action Plan, needs to ensure that BEPS solutions are relevant to, and effective for, developing countries. This means that developing countries must be fully engaged to ensure the solutions take into account the information and capacity gaps they frequently face. Some key concerns of developing countries have already shaped the Action Plan, such as revised transfer pricing rules that includes a template for country-by-country reporting to tax administrations, but the engagement of developing countries in the design of solutions needs to be stepped up. There are opportunities to put in place a more structured dialogue process, with clear avenues for developing countries to work together and directly input on the OECD/G20 BEPS Project. The OECD will strengthen the way it engages with developing countries over the coming months.

- Political level engagement on BEPS issues in many developing countries is at an early stage. G20 members, international and regional organisations, NGOs and other stakeholders can facilitate increased awareness of the importance of BEPS issues at developing country political levels, while recognising that BEPS may not be the highest priority issue in each case.

- G20 countries should analyse the spillover effects of changes to the design of their own tax systems on those of developing countries.

- The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, should assess how practical toolkits can be produced to help developing countries implement key BEPS actions regarding: for example, interest, services and royalties payments; the pricing of exported commodities; issues raised by business restructuring and accessing the information needed to assess and address BEPS. The toolkits will assist developing countries to address the highest priority BEPS issues. They will not create separate or alternative norms or standards.

- Part 1 of the report to the DWG shows that some of the key base erosion challenges faced by developing countries are not addressed in the OECD/G20 BEPS Project. The international and regional organisations can help the G20 to undertake further analyses on the lack of comparability data for transfer pricing, and on structures that indirectly transfer the ownership of an asset situated in a country in a way that avoids taxation by that country of profits arising from an increase in the value of that asset.

- Tax incentives, a major focus of work by the IMF, WBG and others for many years, are still a top priority concern for developing countries. Although outside the Action Plan, the DWG has already suggested further effort and recommendations will be required in 2015.

- The development of the Multilateral Instrument (Action 15) is still in its early stages but has the potential to be an important tool for developing countries that have a tax treaty network. This instrument has the potential to be cost efficient to governments, while providing more certainty to foreign investors.

- The report recognises that capacity development on BEPS issues is critical. There has been extensive work by the international organisations in this area for many years, and the IMF, WBG and others have considerable experience. G20 members are active partners in this field. Some further recent international experience gathered under the auspices of the OECD's Task Force on Tax and Development suggests capacity building on BEPS issues achieves significant results, providing grounds for optimism as the Action Plan rolls out. The report proposes the DWG promotes and endorses the long-standing efforts of the international and regional organisations on BEPS issues, as well as some promising new initiatives such as the OECD's Tax Inspectors Without Borders (TIWB) through which G20 countries are gearing up support to developing country tax administrations.

- To guide their actions to address BEPS, DWG members can note some of the capacity development experiences from developing countries and international organisations. Lessons include the importance of approaching BEPS issues in the context of broader reform plans and development strategies; the role of regional organisations, civil society and business; and the importance of retaining skilled staff.

SECTION 1: INTRODUCTION AND BACKGROUND

At the 2013 St. Petersburg Summit, Group of Twenty (G20) leaders endorsed the St. Petersburg Development Outlook (G20, 2013), which committed the DWG to "review relevant work on base erosion and profit shifting (BEPS) during 2014 in order to identify issues relevant to low income countries (LICs) and consider actions to address them".

In response to this commitment the DWG requested the OECD, working with other international and regional organisations, in particular with the IMF, to report on the main sources of BEPS for LICs and other low capacity countries ('developing countries'), how those sources relate to the Action Plan and how the DWG might assist developing countries to meet those challenges.

Part 1 of this report was based on extensive dialogue and consultations with developing countries, and, in accordance with the DWG's Terms of Reference, drew on the findings of the transfer pricing pilots undertaken by the OECD Task Force on Tax and Development, which featured in the DWG's 2010 Multi-Year Action Plan. A key objective of the OECD's participation in these pilots, undertaken in partnership between the European Union (EU), OECD and WBG, is for the OECD to gain a better understanding of the issues faced by developing countries in implementing internationally developed norms and standards. This is achieved by working directly with developing countries, and the EU and WBG.

Part 1 was discussed at the meeting of the DWG in May 2014. It reported that BEPS is a major concern for developing countries, and found that:

- While BEPS is a global issue, developing countries face specific policy issues and implementation challenges that are not always shared with developed countries;

- Some BEPS Actions are of more immediate relevance and concern to developing countries than others. Over the longer term, however, all BEPS Actions are likely to become important to developing countries as they work through their priority list and strengthen their tax systems accordingly;

- There are other base erosion issues, not covered in the OECD/G20 BEPS Project, which developing countries report are of immediate concern and which are already the subject of considerable technical assistance.

This paper constitutes Part 2 of the report, for discussion at the meeting of DWG in September 2014 in Perth, Australia. It builds on Part 1 and takes account of further consultations with developing countries and the comments received from the DWG meeting in May 2014.

This report proposes recommendations for the DWG to:

- Call on the OECD to ensure engagement with developing countries is stepped up so that BEPS solutions take account of specific capacity and political challenges faced by developing countries (in Section 2 below).

- Call on the OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how they can assist developing countries address the challenges they face in relation to action items in the Action Plan (in Section 3 below).

- Call on the OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how they can assist developing countries address the challenges they face from other BEPS related issues outside of the Action Plan (in Section 4 below).

- Welcome the work being carried out by international organisations in response to capacity development issues (in Section 5 below).

These recommendations are summarised in Section 6.

SECTION 2: STEPPING UP ENGAGEMENT WITH DEVELOPING COUNTRIES TO ADDRESS BEPS CHALLENGES AT TECHNICAL AND POLITICAL LEVELS

Part 1 of this report concluded that developing countries face challenges not always shared by developed countries. In particular it identified information and capacity gaps exacerbated by a lack of political awareness of these challenges. These have a number of implications that are discussed in this Section.

a) Engagement with developing countries to ensure the specific challenges they face are taken into account in designing BEPS solutions

BEPS is a global issue requiring solutions that are relevant for developing countries and effective in addressing their specific capacity and resource constraints. The design of BEPS solutions cannot ignore these constraints, and developing country views and perspectives must impact on BEPS solutions.

There has already been significant engagement between the OECD/G20 BEPS Project and developing countries which has already shaped the OECD/G20 BEPS agenda (see Box 1 below).

Box 1. Shaping the OECD/G20 BEPS agenda

Dialogue with developing countries has shaped the OECD/G20 BEPS agenda in several key areas:

- Work has begun in response to **concerns expressed by developing countries about the lack of quality comparability data** in their countries that can be used for transfer pricing purposes. Further details of this work are set out in Section 5 b) below.
- Revision of the Transfer Pricing Guidelines on documentation (Action 13) in response to developing country concerns that they face significant challenges in **obtaining the information they need to apply their transfer pricing rules.** This includes a **template for country-by-country reporting** to tax administrations of income, taxes and economic activity to meet the demands from many developing countries for the introduction of some form of country-by-country reporting. This will assist developing country tax administrations that have faced significant challenges in building a "big picture" view of a taxpayer's global operations.
- New **guidance on safe harbours** for transfer pricing purposes have been produced in response to the concerns expressed by many developing countries that they face significant capacity issues in implementing highly complex transfer pricing rules and need some simplification measures. The guidance provides a basis for countries, especially developing countries, to design a transfer pricing compliance environment that makes optimal use of the limited resources available.
- In the context of the OECD/G20 BEPS Project, work is underway to develop transfer pricing rules to provide **protection against common types of base eroding payments**, such as service fees which were identified as a significant BEPS issue by developing countries during the BEPS consultation process.
- The **model anti-abuse provisions** that countries can include in treaties have been designed under the OECD/G20 BEPS Project to make it possible for tax administrations with limited capacity to administer them.

As the evidence base grows, indicating the importance of BEPS to the developing world, the time is right for the dialogue to be taken to a new level. There are opportunities to put in place a more structured dialogue process, with clear avenues for developing countries to work together and directly input into the work under the Action Plan. The OECD will strengthen the way it engages with developing countries over the coming months.

Recommendations

The DWG calls on:

1. The OECD/G20 BEPS Project to ensure that the outcomes of the Project take into account the specific challenges faced by developing countries, in particular in the highest priority Actions for developing countries (Actions 4, 6, 7, 10, 11, and 13).

2. The OECD to put in place a new structured dialogue process, with clear avenues for developing countries to work together and directly input into the OECD/G20 BEPS Project.

b) Need for stronger political awareness within both developing and developed countries

i) Political awareness in developing countries of the potential impact of BEPS on their country's tax base

The IMF regularly engages with its members on international tax issues, most intensely in its technical assistance work. Yet countries in the consultation process frequently reported the need to achieve political buy-in as a prerequisite to making the legislative changes and resource commitment required to counter BEPS. Many developing countries report that there is a lack of awareness at a political level on the need for action and reform. Box 2 below reports, as an example, the conclusions of Australia and New Zealand regarding the profile of BEPS in Pacific Island countries.

Box 2. Pacific Island countries have limited awareness of BEPS

In Australia and New Zealand's bi-lateral consultations with Pacific Island countries (PICs) most reported very little awareness of BEPS issues. Based on these consultations Australia and New Zealand see a need to engage further with PICs to build awareness of how BEPS affects broader domestic resource mobilisation efforts.

All stakeholders — G20 countries, international and regional organisations, civil society and donors — that have access to political levels in developing countries have a role to play in explaining BEPS risks and in bringing these issues to the attention of Ministers in government departments other than tax administrations, in particular Ministries of Finance.

Recommendations

The DWG calls on:

3. All stakeholders – G20 countries, international and regional organisations, civil society and donors – to raise awareness of the significance of BEPS issues at political levels in developing countries by holding high-level political dialogue on BEPS issues with developing country Ministers from Ministries of Finance and other relevant Ministries.

ii) Political awareness in developed countries of the potential spillover effects of changes to their tax systems on BEPS related issues in developing countries

The 2011 report from the international organisations to the DWG (OECD, 2011) recommended that developed countries undertake spillover analysis of the impact of any significant changes to their own tax systems on those of developing countries. The issue is further highlighted in Action 11 of the Action Plan, which includes the development of an economic analysis of the scale and impact of BEPS (including spillover effects across countries). In light of these developments, and the recent work undertaken by the IMF (IMF, 2014) on this topic, G20 countries should analyse the spillover effects of revisions made to their own tax systems on those of developing countries.

Recommendations

The DWG suggests:

4. G20 countries should analyse the spillover effects of revisions made to their own tax systems on those of developing countries.

SECTION 3: POTENTIAL ACTIONS TO ASSIST DEVELOPING COUNTRIES ON HIGH PRIORITY BEPS ISSUES

Section 3 and section 4 of this paper recommend that the DWG calls on international and regional organisations, where appropriate and in a position to do so, to assess how practical toolkits can be produced to assist developing countries implement key BEPS outcomes and to address the difficulties caused by a lack of comparability data. There is a clear need for this work but further discussion is required on how such toolkits should be developed, what they should cover, how the different international and regional organisations can assist in their development and the timelines going forward.

a) Base eroding payments between Multinational Enterprise (MNE) related parties

The profit-shifting risk of payments between related companies is one of the most frequently reported concerns of developing countries. Many consider that excessive or unwarranted payments by MNE taxpayers to foreign related companies represent a significant risk to their tax bases. They similarly report concerns about profit shifting through under-priced export sales to foreign related parties.

Risks arising from excessive or unwarranted payments are frequently reported in relation to payments of interest and royalties, or to fees paid for management or other services. Countries often find it difficult to apply the criteria contained in the current international tax rules to assess whether such payments are excessive or unwarranted.

Risks arising from under-pricing of exports to related parties occur in all industries, but are especially significant for some mineral and commodity products, where, again, international tax rules may be difficult to apply. This has led some resource rich countries to introduce rules intended to counter these specific risks. Box 3 below describes the rule introduced by Zambia, which is an example of rules sometimes described as the “Sixth Method”.

Box 3. Pragmatic adaptation: Zambia’s special rule on metals pricing

Zambia has introduced rules that apply to the sale of base metals or any substance containing base metals or precious metals between related parties. In such transactions the sale price for tax purposes will be broadly the monthly average quoted price on metal exchange markets.

The Action Plan addresses these types of risks under Actions 4 and 10. It is important that the design of BEPS solutions under these Actions takes account of the challenges that developing countries report in applying current international rules to these risks. The Zambian case illustrates the type of adaptation potentially of value and interest to many other countries together with tools that enable them to effectively implement BEPS solutions associated with these risks.

Recommendations

The DWG calls on:

5. The OECD/G20 BEPS Project to ensure that Actions 4 and 10 take into account developing country issues.

6. The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how practical toolkits can be produced to assist them implement rules to address BEPS issues relating to base eroding payments between MNE affiliates.

A toolkit might, for example, consist of:

- An explanatory note, describing how risks from base eroding payments between MNE affiliates arise.
- A paper on policy considerations and implications related to measures to counter tax loss arising from such payments.
- A description and analysis of regulatory options available, such as transfer pricing, thin capitalisation, anti-avoidance rules, BEPS special measures, as well as treaty measures, outlining potential advantages and disadvantages of each, in the light of country experiences to date.
- Model legislation and explanatory notes.
- Guidance on the administration of regulatory options (including governance), and practical auditing techniques.
- Supporting training materials.

b) Challenges created by new ways of doing business

As set out in Part 1 of the report the increasing mobility of capital and people, and the rapid adoption of technology to improve communications, has resulted in restructuring of MNE business models and operations.

Such restructurings offer the opportunity to contractually shift risk and valuable intellectual property from, for example, local distributors to a central entrepreneurial company (the principal) in a low tax jurisdiction. This ability to contractually shift risk and intellectual property between the members of an MNE (but not outside the MNE group as a whole) allows MNEs to plan where profits are reported, and thus tax paid.

Developing country tax administrations are seeing many such restructurings and challenging them frequently involves the interaction of a number of international tax rules—transfer pricing rules, tax treaties, the taxation of non-residents, and rules concerning the transfer of intangible assets.

The Action Plan recognises these rules have weaknesses that create opportunities for BEPS and these are being addressed by Actions 7, 8 and 9. It is important that the design of BEPS solutions through these actions takes account of developing country concerns and they are provided with the tools to enable them to implement the solutions. The box below proposes recommendations to address these issues.

Recommendations

The DWG calls on:

7. The OECD/G20 BEPS Project to ensure that BEPS Actions concerning the rules to counter artificial profit shifting through supply chain restructuring, for example the definition of a Permanent Establishment (Action 7), risk allocation and intangibles (Action 8 and 9), take into account developing country capacity limitations and information gaps.

8. The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how practical toolkits can be produced to assist developing countries implement rules to counter artificial profit shifting through supply chain restructuring.

A toolkit might, for example, consist of:

- An explanatory note, explaining how and why businesses restructure their supply chains, and the tax implications. This will include a description of the different supply chain models MNEs typically employ and guidance on how to identify a business restructuring has taken place.
- A paper on policy considerations in designing measures to ensure that MNEs that undergo, or have undergone, business restructuring pay the right amount of tax in each of the locations in which they operate.
- A description and analysis of the regulatory tools available to counter BEPS arising from business restructuring. These include transfer pricing, permanent establishment issues, residency issues, treaty measures, anti – avoidance rules and BEPS special measures.
- Guidance on the administration of regulatory measures, including how to assess the BEPS risks from the restructuring on risk assessment and practical auditing techniques.
- Supporting training materials.

c) Information needed to assess and address BEPS issues

A major issue for developing countries is the ability to obtain information needed to assess the scale and impact of cross-border tax avoidance, and to take effective action to counter such avoidance. Developing countries need data to adequately quantify tax loss from cross-border tax avoidance, and to pinpoint the sources and nature of such losses, as well as the effectiveness of measures introduced to counter them. This issue is being addressed by Action 11.

Again, it is important that the design of BEPS solutions through Action 11 takes account of developing country constraints and such countries are provided with the tools to enable them to implement the solutions.

In addition, despite many developing countries introducing transfer pricing documentation rules they still often face significant challenges in obtaining the information they require to select the most appropriate taxpayers for audit, and then to effectively check or challenge their transfer pricing and other cross-border practices.

These countries see significant value in the revised guidance on transfer pricing documentation rules and the country-by-country template being developed under Action 13 but have reported they will require supplementary tools and instruments to implement the guidance.

The box below proposes recommendations to address these issues.

Recommendations

The DWG calls on:

9. The OECD/G20 BEPS Project to ensure that Action 11 takes into account developing country issues.

10. International and regional organisations, where appropriate and in a position to do so, to assess how tools and materials can be developed to assist developing countries assess the risks they face from BEPS.

11. The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how practical toolkits can be produced to support the successful implementation by developing countries of a) assessment of BEPS risks, and b) effective transfer pricing documentation requirements that balance compliance imperatives with compliance costs. The toolkit might, for example, consist of:

- Model legislation and explanatory notes.
- Reviews of country information requirements, procedures and practices.
- Supporting training materials.

d) Challenges deriving from the abuse of treaties

Whilst developing countries generally agree that bilateral tax treaties have been effective in preventing double taxation, and support a predictable investment landscape, they are deeply concerned about their misuse.

The main concern is focused on the use of techniques (sometimes called “treaty shopping’’) to obtain treaty benefits (typically the reduction of withholding taxes) in situations in which such benefits were not intended.

Action 6 addresses such misuse by designing model anti-abuse provisions that countries can include in treaties. The design of these provisions ensures the provisions are capable of being effectively administered by tax administrations with limited capacity.

Developing countries are also concerned that the interpretation of the treaty rules on Permanent Establishments allow contracts for the sale of goods belonging to a foreign company to be negotiated and concluded in the country by the sales force of a local subsidiary on behalf of that foreign company. This can lead to the profits from these sales not being taxable to the same extent as they would have been if the sales were made by the local subsidiary. Action 7 will develop changes to the definition of Permanent Establishments to address challenges posed by what is technically referred to as “commissionaire structures”.

A wider concern expressed by developing countries, and highlighted by NGOs in particular (McGauran, 2013), concerns the relative costs and benefits of entering into treaties. This raises both practical issues, such as the capacity of developing countries to ensure the treaty terms they negotiate are beneficial to the country, as well as policy considerations that countries should analyse before deciding to enter into a tax treaty with another country.

The box below proposes recommendations by the DWG to address these issues.

Recommendations

The DWG calls on :

12. The OECD/G20 BEPS Project to ensure that Actions 6 and 7 take into account developing country issues.

13. The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how to strengthen capacity development on treaty negotiation.

e) Use of the multilateral instrument developed under Action 15

Although the development of a multilateral instrument has not been identified as high priority by developing countries, the work by the OECD under Action 15 of the Action Plan to develop a multilateral instrument will minimize the cost and time required to modify bilateral tax treaty provisions. The multilateral instrument will be open to all countries and has the potential to be an important tool for developing countries to assist them counter BEPS issues and to provide more certainty to foreign investors.

Recommendations

The DWG calls on:

14. G20 countries to engage in dialogue with developing countries on the design and potential benefits of the Multilateral Instrument.

SECTION 4: POTENTIAL ACTIONS ON OTHER BASE EROSION ISSUES OF HIGH PRIORITY TO DEVELOPING COUNTRIES

a) Tax loss on indirect transfer of assets

Developing countries report that the profit made by the owner of an asset when selling it (for example, the sale of a mineral licence) is often not taxed in the country in which the asset is situated. Artificial structures are being used in some cases to make an ‘indirect transfer’; for example through the sale of the shares in the company that owns the asset rather than the sale of the asset itself.

The IMF reports some recent cases in developing countries of significant gains on indirect transfers of assets being untaxed (or with tax disputed) by the country where the underlying assets are located (see Box 4 below).

Box 4. Examples of indirect transfers

Mauritania: A Canadian company effectively acquired an interest in a large gold mining project [in Mauritania] from another Canadian company via a transaction in the Bahamas in 2010, with a potential capital gain of US$4 billion. No tax was collected on the transaction in Mauritania.

Mozambique: In 2011 a change in ownership of mining projects in Mozambique was achieved through the sale, on the Australian stock market, of shares in the mining company holding interests in the projects. The value of the transaction was around US$4 billion. No tax was collected on the transaction in Mozambique. In the case of the sales of shares in the exploration concessions in the Rovuma basin, the authorities have collected US$1.1 billion in capital gains taxes in 2013-14. Changes were made to the tax code, on January 1, 2014, to ensure taxation of capital gains resulting from a direct or indirect transfer between non-residents of assets located in Mozambique (International Monetary Fund, 2014).

The UN Committee of Experts on International Cooperation in Tax Matters is also currently considering some of these issues in the context of tax treaties, as well as domestic law issues in the extractive industries.

Further work needs to be carried out on how domestic and international tax rules could be designed to address the indirect transfers of assets, in the developing country context.

Recommendations

The DWG calls on:

15. The OECD, in consultation with the IMF, to report on whether further analysis on this issue is needed to identify policy options to tackle abusive cases, with particular reference to developing countries.

b) Lack of data for transfer pricing comparability analyses

The international standard in transfer pricing, which is usually incorporated in domestic transfer pricing rules, requires MNEs to price their related-party transactions in line with the pricing they would have used if they were conducting the same transactions with unrelated parties. Financial data about transactions between unrelated parties (referred to as "comparable transactions") is thus important for countries to be able to effectively enforce their transfer pricing rules.

Developing countries often lack financial data on comparable transactions[3] effecting the application of transfer pricing rules to MNEs in all industries, but the lack of data on the pricing of certain natural resources is often particularly detrimental for developing countries. Some countries are starting to take measures to increase the data that might be used for transfer pricing purposes. Box 5 describes the approach taken by Kenya.

Box 5. Kenya expands data sources for transfer pricing analyses

Kenya has concerns regarding the availability and quality of financial data that might be used for transfer pricing purposes. To improve the data available it has introduced a requirement in its Companies Bill for statutory accounts to be filed with the central registry and to be made publicly available.

Developing countries recognise that measures such as those taken by Kenya above will assist, but they have also expressed an interest in:

- The development of additional tools (e.g. a template for carrying out searches for comparables), materials and training programmes on the use of available databases;
- The development of a toolkit to assist developing countries make appropriate use of foreign comparables (i.e. data on entities in a foreign country); and
- Work on alternative approaches to applying internationally agreed principles in the absence of reliable data on comparables, including work on safe harbours and approaches that operate in ways similar to the "Sixth Method" referred to in Section 3 a) above.

[3] Measures to address this issue are discussed in the OECD document *Transfer Pricing Comparability Data and Developing Countries* (OECD, 2014).

Recommendations

The DWG:

16. Welcomes further work by the OECD and WBG to assess how practical toolkits can be produced to a) assist developing countries address difficulties in accessing comparables data and b) use approaches to apply internationally accepted principles in the absence of comparables (for example, safe harbour provisions).

A. Improving access to comparability data and the effectiveness of its use

A toolkit might, for example, consist of:

- An explanatory note, describing the role of comparables data in transfer pricing and implications of the inability to access such data.
- A description and analysis of measures developing countries might take to improve access to comparables data (such as expanding the scope and use of databases and the use of foreign comparables) or to reduce reliance on comparability data (including the use of measures and approaches such as the 'sixth method' that do not rely on the availability of such data).
- Model legislation and explanatory notes, where needed.
- Supporting training materials.

B. Safe harbours

A toolkit might, for example, consist of:

- An explanatory note, describing the key features of safe harbours and country approaches.
- A paper on policy considerations and implications of introducing a safe harbour regime.
- A description and analysis of regulatory options available, including developing country experience to date.
- Model legislation and explanatory notes.
- Guidance on the administration of safe harbours.
- Supporting training materials.

17. Calls on the OECD to commence a study on the feasibility of addressing the information gap on prices of some natural minerals sold in an intermediate form, e.g. mineral concentrate.

c) *Wasteful tax incentives*

Although outside of the Action Plan, Part 1 of this report raised concerns from developing countries about potentially wasteful tax incentives that erode the tax base with little demonstrable impact on investment. Many efforts are underway by governments, international and regional organisations and civil society to address these concerns. The IMF and WBG have analysed the problem and provided support to developing countries for decades.[4] Recently, the OECD's Task Force on Tax and Development has proposed a set of *draft principles to enhance the transparency and governance of tax incentives for investment in developing countries* (OECD, 2013), that can be used as a diagnostic framework to analyse the problem in developing countries (see Annex 1). The G20 now has an opportunity to bring much of the existing knowledge together and to raise the profile. Using country-studies and focusing on governance and transparency, guidance could be developed for developing countries to better balance investment and tax revenue priorities.

Recommendations

The DWG welcomes:

18. A report (in 2015) on good practice in transparency and governance on tax incentives in developing countries from the IMF, OECD, UN and the WBG, using case studies, to better guide the developing countries in:

- Balancing investment and public revenue priorities.
- Estimating the cost of tax incentives, including revenue leakages due to unintended tax planning opportunities.

[4] See for example, James (2013), Klemm and Van Parys (2009).

SECTION 5: CURRENT BEPS CAPACITY DEVELOPMENT ISSUES INVOLVING INTERNATIONAL ASSISTANCE PROVIDERS

Part 1 of this report relayed a clear message from developing countries that capacity development is critical to the successful implementation of measures to counter BEPS. The IMF, WBG and others have provided extensive support, including on international tax issues and tax incentives, and including through investment lending support, on strengthening tax policy and administration in developing countries for many years, with many positive results (OECD, 2011). More recently, International organisations have gathered specific evidence to show capacity development on BEPS issues can make a significant difference, including impacting on domestic resource mobilisation (see Box 6 below). This provides some grounds for optimism that BEPS solutions, with the right support, can be successfully implemented in developing countries as the BEPS Action Plan rolls out.

Box 6. Capacity development makes a difference

In 2011 the OECD, WBG and EU, began a programme of support for developing countries seeking to strengthen their transfer pricing rules and their implementation. Support initiatives are now in place in Colombia, Ethiopia, Ghana, Kenya, Peru, Rwanda, Vietnam and Zambia. Other country and regional projects are in the formative stages, including in Cambodia, the East African Community (EAC) and the Economic Community of West African States (ECOWAS) region. Key impacts of the programme include:

- Improved transfer pricing legislation and a new a transfer pricing decree in **Colombia**, aligned to international standards. Following transfer pricing adjustments made as a result of audits of MNEs, the Colombian tax administration has increased revenues from US$3.3 million in 2011 to US$5.83 million in 2012 (a 76% increase).
- Increased revenue collection in **Kenya**, from US$52 million for year ended 30 June 2012 to US$85 million for year ended 30 June 2013, following a training programme on advanced transfer pricing issues.
- New transfer pricing regulations in **Ghana** together with supporting guidance and a transfer pricing return schedule, complemented by a comprehensive skills-building programme with a newly established team of specialist transfer pricing auditors leading to the first transfer pricing audits in Ghana being started in 2014.
- Significantly improved capacity in **Vietnam** to enforce its transfer pricing rules, resulting in an increase in the number of audits conducted by the tax administration from one audit in 2012 to 40 audits in 2013, giving rise to transfer pricing adjustments of US$110 million by the end of 2013.

With globalisation and a greater focus on BEPS, demand for capacity development assistance is increasing rapidly. G20 countries are already active in the tax and development cooperation area, including in addressing BEPS. Examples gathered by the G20 Presidency include: Australia, China, Germany, Japan, Korea, and Russia providing assistance to Timor-Leste, Democratic Republic of Congo, Ghana, Malaysia, African Tax Administration Forum (ATAF) member countries, and Europe and Central Asia (ECA) countries respectively. In addition, the UK is supporting the OECD and World Bank Group to deliver their transfer pricing programmes. As further resources for support are deployed towards this area, the G20 can draw on some of the lessons learned from experience, described in the paragraphs below.

a) Setting BEPS issues in the context of country-led reform plans and priorities

The 2011 report from the international organisations to the DWG (OECD, 2011) noted that a series of problems plague the poorest countries including corruption, the informal sector and various tax policy and administration concerns. This diagnosis remains true today and is a useful reminder that, as the focus on international tax matters intensifies, BEPS issues must be seen as an issue that needs to be addressed in step with a broader range of reforms that each country undertakes, and in accordance with each country's policy agenda. For international assistance providers, Box 7 below provides some examples of tools and approaches developed to ensure that international support targets the most pressing needs.

Box 7. Approaching BEPS in context

The IMF's Tax Administration Diagnostic Assessment Tool (TADAT) is a diagnostic tool to help developing countries and international assistance providers see priorities in a comprehensive and strategic manner. In turn, this will help to set out how BEPS issues fit into wider reform contexts.

The WBG's IAMTAX is a benchmarking, diagnostic and monitoring tool which allows for a comprehensive assessment of tax administration performance. It is used for diagnosing a broad range of issues in a country and monitoring those over time.

Germany's Gesellschaft für Internationale Zusammenarbeit (GIZ) Good Financial Governance programme in Ghana supports a range of public financial management concerns. In this case, the support from OECD/WBG/EU on transfer pricing provides a contribution, and is designed and sequenced according to a broader set of related public financial management reforms and priorities.

b) Regional organisations and BEPS capacity development issues

Regional organisations have extensive membership and are increasingly influential in and beyond their regions. For example, ATAF now has 38 member countries, and has established a BEPS Working Group to lead an African approach to BEPS and give input into the OECD/G20 BEPS process.

Box 8 below describes steps already taken in Africa to increase collective action and co-operation, illustrating that regional organisations can act as powerful platforms to address BEPS capacity development issues.

Box 8. Acting regionally: mutual assistance among African countries

ATAF has developed the ATAF Agreement on Mutual Assistance in Tax Matters (AMATM). This multilateral instrument allows for the exchange of information, sharing of expertise, joint audits and investigations, and mutual administrative assistance among African countries. The AMATM has the potential to be a key instrument in the fight against BEPS in Africa.

In Latin America, the Inter-American Center of Tax Administrations (CIAT) is actively supporting the BEPS initiative. A BEPS workshop was co-sponsored in February 2014 in Colombia with a large number of Latin American and Caribbean (LAC) tax officials present. In October 2014 a follow-up to that event will be hosted in Spain during CIAT's Technical Conference. CIAT is also co-sponsoring seminars on transfer pricing in LAC, most recently in Trinidad and Tobago and Uruguay.

The Pacific Islands Tax Administration Association (PITAA) meeting in July 2014 provided an opportunity for senior tax officials to discuss BEPS issues relating to PICs.

c) Engaging with all stakeholders

Business and civil society both have key roles to play in the design and delivery of capacity development, and both stakeholders increasingly have a regular place in the dialogue on BEPS issues with governments in developing countries. They also have a role in complementing the efforts of international assistance providers. Business insights into the investment climate implications of BEPS, for example, can be important. Business can provide a unique source of highly valued industry knowledge to support actions to address BEPS.

Civil society has an equally important role to play in raising awareness of the significance of BEPS issues amongst developing country governments, international organisations and donors, and engagement by providers of support and local NGOs is to be encouraged.

Examples of promising partnerships are highlighted in Box 9 below.

Box 9. Working with business and civil society on BEPS issues in Zambia and Colombia

Colombia and Zambia are working with business and civil society, supported by the OECD/WBG/EU programme on transfer pricing.

Unilever is working with the Colombian Tax Administration (DIAN) and OECD/WBG to provide training on the consumer goods industry and its supply chain in 2014.

With the OECD, the mining industry is providing experts to help Colombia and Zambia to analyse the coal, copper and gold industry supply chains – all key BEPS risk areas.

The OECD and WBG are working closely with the Zambia Extractive Industries Transparency Initiative Secretariat on issues to improve transparency in financial reporting in Zambia.

d) Setting objectives and measuring results

Governments in developing countries are paying greater attention to setting out clear and measurable objectives for their own reform strategies on BEPS issues and from the support provided by international development partners. To support these efforts, the OECD and WBG have developed a results framework as a tool to discuss and define objectives with developing countries. For example, the programme with Ethiopia has a key objective of assessing the impact the introduction of safe harbour regulations has on creating a more certain investment climate and assisting the tax administration in ensuring its limited resources are used in the most effective way.

e) Addressing institutional, organisational and individual needs

The 2011 report to the G20 noted international assistance on tax matters should encompass institutional, organisational and individual issues in order to make a difference. This observation remains valid as international providers of assistance engage with more intensity on BEPS issues. New transfer pricing legislation, for example, will have little or no impact if an administrative structure for enforcing them does not exist. Similarly, the effectiveness of such rules will be severely impaired if auditors responsible for enforcing them lack the requisite skills. Capacity building thus needs to encompass a full spectrum of issues including: policy development; legislation and guidance; administrative structure and governance; risk assessment and practical auditing skills.

f) Assessing and addressing BEPS issues holistically

The BEPS Action Plan has highlighted the interactions between the various international tax rules that relate to BEPS and Part 1 of this report noted that capacity development on BEPS actions needs to encompass all BEPS issues of priority to developing countries.

The scope of capacity building programmes to assist developing countries on BEPS Actions should be designed to build effective regimes able to address all issues relating to BEPS. Each country context will vary, but where relevant may include transfer pricing, treaty issues, Permanent Establishment issues and thin capitalisation issues. Box 10 illustrates the point in the case of Nigeria.

Box 10. A holistic approach to addressing BEPS risks in Nigeria

Following a risk and needs assessment, Nigeria's Federal Inland Revenue Service (FIRS) identified that it faces significant risk to its tax base from i) abusive and inappropriate transfer pricing, ii) excessive interest payments out of Nigeria, iii) abuse of some of Nigeria's tax treaties, and iv) abuse of the definition of permanent establishments. Based on these findings the OECD/WBG/EU capacity development programme has been designed to address these concerns and to sequence different actions accordingly.

g) Hands-on and focused support

Many developing countries report that much of the training they have received over a number of years has focused on theory and principles. Such training has been useful as an initial step to raise awareness of the type of rules needed to counter base erosion and profit shifting, but there is high demand for a focus on the practical implementation of rules, skills building and peer-learning, centred on practical case studies and issues encountered by the tax administration. The IMF, WBG and others have, of course long recognised this and have extensive programmes of support in place. The transmission of skills and knowledge through hands-on support on real issues and cases is proving effective. The OECD's Tax Inspectors Without Borders (TIWB) described in Box 11 below is designed to respond to demand for such support by mobilising specialist audit skills.

Box 11. The OECD's "Tax Inspectors Without Borders" (TIWB) Initiative

The OECD's TIWB is a new project which deploys tax audit experts to work directly under the management and supervision of local officials in developing country tax administrations on audits, with a particular emphasis on international tax matters, including those covered in the Action Plan. TIWB programmes complement existing initiatives that focus on putting in place the regulatory and administrative building-blocks needed to counter base erosion and profit shifting, through a real-time, "learning by doing" approach to solve current audit issues while transferring knowledge and skills. TIWB assistance can cover direct and indirect tax audit issues including pre-audit risk assessment and case selection, audit investigatory techniques, audit cases involving transfer pricing issues, anti-avoidance rules, or sector-specific issues, relating for example to e-commerce, natural resources, financial services or telecommunications. TIWB programmes can be full-time, or involve periodic assistance, and there is no minimum or maximum period.

Most importantly, TIWB can assist with improving the quality and consistency of tax audits, achieving sustained improvements in tax audit skills, and a resulting rise in the level of voluntary compliance by taxpayers who see a strengthening of tax administrations' ability to carry out their mandate. The project is in a pilot phase in 2014, with requests for experts from Albania, Ghana, Malawi, Papua New Guinea, Senegal and Vietnam currently being met by France, India, Italy, the Netherlands, South Africa and the United Kingdom.

h) Sustaining practical skills and knowledge

Competitive terms and conditions of employment are needed in tax administrations to ensure that officials with practical skills and knowledge are not lost to the private sector. For their part, providers of international assistance should be alert to the risks of building the practical skills of officials if they are only to be lost to the private sector. Box 12 below illustrates the measures Kenya has taken to ensure staff with specialist international tax knowledge and experience are retained.

Box 12. Retaining specialist skills in Kenya's tax authority

The Kenyan Revenue Authority (KRA) has been successful in retaining the staff in its transfer pricing team. The KRA considers it has been able to achieve this through a combination of factors including providing market rate remuneration packages, strong leadership and a strong team ethic. The stability and experience developed within the team has assisted the KRA to build an effective transfer pricing regime to address BEPS related issues and achieve substantial year on year revenue increases from transfer pricing adjustments. The KRA reports that the IMF noted recently that the Kenyan tax administration was now well equipped to handle complex issues such as transfer pricing.

Recommendations concerning capacity development

The issues set out in this section align to the five actions set out in the G20 DWG guiding framework for response to capacity issues arising from the G20 agenda that was agreed at the G20 DWG meeting in Hobart on 8th to 9th May 2014.

Recommendations

The DWG promotes and endorses:

19. Capacity development programmes from international organisations on BEPS issues.

20. The OECD/WBG/business partnership to build industry knowledge in developing country tax administrations.

21. The OECD's 'Tax Inspectors Without Borders' initiative as a tool to build developing country capacity to implement BEPS solutions.

22. The proposed initiatives of regional organisations, and regional programmes, to assist developing countries on BEPS issues.

SECTION 6: CONCLUSION AND SUMMARY OF RECOMMENDATIONS

This report has set out how the DWG might assist developing countries meet the challenges of the most relevant BEPS issues they face, both the most relevant action items in the Action Plan and the most relevant other BEPS-related issues. However, this report comes in the mid-point of the OECD/G20 BEPS project and is by no means the final word on the impact of BEPS on developing countries. As BEPS solutions are finalised the recommendations and findings of this report will need to be reviewed and updated to reflect these solutions. Developing countries should be engaged throughout this process.

The table below summarises proposed recommendations for the DWG to address the BEPS issues of highest concern to developing countries, identified in Part 1 of this report.

Issue	Recommendation
Continuing dialogue with developing countries to ensure developing country issues are taken into account	The DWG calls on: **1.** The OECD/G20 BEPS Project to ensure that the outcomes of the project take into account the specific challenges faced by developing countries, in particular in the highest priority Actions for developing countries (Actions 4, 6, 7, 10, 11, and 13). **2.** The OECD to put in place a new structured dialogue process, with clear avenues for developing countries to work together and directly input into the OECD/G20 BEPS Project. **3.** All stakeholders – G20 countries, international and regional organisations, civil society and donors – to raise awareness of the significance of BEPS issues at political levels in developing countries by holding high-level political dialogue on BEPS issues with developing country Ministers of Ministries of Finance and other relevant Ministries. **4.** G20 countries should analyse the spillover effects of revisions made to their own tax systems on those of developing countries.
Development of toolkits to assist developing countries implement BEPS solutions	The DWG calls on: **5.** The OECD/G20 BEPS Project to ensure that Actions 4 and 10 take into account developing country issues. **6.** The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how practical toolkits can be produced to assist developing countries **a**ddress base eroding payments

	between MNE affiliates. **7.** The OECD/G20 BEPS Project to ensure that BEPS Actions concerning the rules to counter artificial profit shifting through supply chain restructuring. **8.** The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how practical toolkits can be produced to assist developing countries implement rules to counter artificial profit shifting through supply chain restructuring. **9.** The OECD/G20 BEPS Project to ensure that Action 11 takes into account developing country issues. **10.** International and regional organisations, where appropriate and in a position to do so, to assess how tools and materials can be developed to assist developing countries assess the risks they face from BEPS. **11.** The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how practical toolkits can be produced to support the successful implementation by developing countries of a) assessment of BEPS risks, and b) effective transfer pricing documentation requirements.
Challenges deriving from the abuse of treaties	The DWG calls on : **12.** The OECD/G20 BEPS Project to ensure that Actions 6 and 7 take into account developing country issues. **13.** The OECD, IMF, UN, WBG and regional organisations, where appropriate and they are in a position to do so, to assess how to strengthen capacity development on treaty negotiation.
Use of the Multilateral Instrument	The DWG calls on: **14.** G20 countries to engage in dialogue with developing countries on the design and potential benefits of the Multilateral Instrument.
Addressing tax loss on indirect transfer of assets	The DWG calls on: **15.** The OECD, in consultation with the IMF, to report on whether further analysis on this issue is needed to identify policy options to tackle abusive cases, with particular reference to developing countries.
Addressing lack of transfer pricing comparability data	The DWG: **16.** Welcomes further work by the OECD and WBG to assess how practical toolkits can be produced to a) assist

	developing countries address difficulties in accessing comparables data and b) use approaches to apply internationally accepted principles in the absence of comparables (for example, safe harbour provisions). **17.** Calls on the OECD to commence a study on the feasibility of addressing the information gap on prices of some natural minerals sold in an intermediate form, e.g. mineral concentrate.
Addressing wasteful tax incentives	The DWG welcomes: **18.** A report in 2015 on good practice in transparency and governance on tax incentives in developing countries from the IMF, OECD, UN and the WBG to better guide the developing countries in: • balancing investment and public revenue priorities. • estimating the cost of tax incentives, including revenue leakages due to unintended tax planning opportunities.
Capacity development	The DWG promotes and endorses: **19.** Capacity development programmes from international organisations on BEPS issues. **20.** The OECD/WBG/business partnership to build industry knowledge in developing country tax administrations. **21.** The ‘Tax Inspectors Without Borders’ initiative as a tool to build developing country capacity to implement BEPS solutions. **22.** The proposed initiatives of regional organisations, and regional programmes, to assist developing countries on BEPS issues.

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ANNEX 1:

SELECTED DEVELOPING COUNTRIES EXPERIENCES SET OUT AGAINST THE OECD TASK FORCE ON TAX AND DEVELOPMENT PRINCIPLES TO ENHANCE THE TRANSPARENCY AND GOVERNANCE OF TAX INCENTIVES FOR INVESTMENT IN DEVELOPING COUNTRIES

Principle 1. Make public a statement of all tax incentives for investment and their objectives within a governing framework.

A public statement of the full extent of tax incentives in Nigeria is hard to achieve due to the complexity of the tax incentives framework. Tax incentives can also be introduced through laws (currently including as many as 15 acts and provisions), budget speeches, government notices, executed agreements, as well as Memoranda of Understanding between the government and businesses.

Principle 2. Provide tax incentives for investment through tax laws only.

In 2009, the Code of Fiscal Benefits harmonised most investment incentives in Mozambique. In 2013, as many as 17 laws and legislative acts were consolidated into the General Tax Code in Senegal, significantly improving transparency of the tax system.

Principle 3. Consolidate all tax incentives for investment under the authority of one government body, where possible.

In Ghana, as many as 10 organizations/agencies have the authority to recommend or grant tax incentives and exemptions.

Principle 4. Ensure tax incentives for investment are ratified through the law making body or parliament.

Proposed tax incentives measures in Zambia are announced through a budget speech delivered in Parliament by the Minister of Finance; and are debated, voted, and passed by Parliament.

Principle 5. Administer tax incentives for investment in a transparent manner.

The administration process for the Swaziland's Development Approval Order is opaque and includes discretionary eligibility criteria such as "beneficial to the development of the economy." The application process is long and time-consuming; it doesn't follow a set timeline.

Principle 6. Calculate the amount of revenue forgone attributable to tax incentives for investment and publicly release a statement of tax expenditures.

> In Tanzania, in the 2013-2014 Budget Speech, the Government voiced a commitment to rationalise the existing investment incentives, in particular, to reduce tax exemptions from 4.3% of GDP in 2011-12 to a maximum of 1% by 2014, based on systematic analysis of revenues foregone.

Principle 7. Carry out periodic review of the continuance of existing tax incentives by assessing the extent to which they meet the stated objectives.

> Impact evaluation of investment incentives in Mauritius prompted a move away from an investment regime of numerous and overlapping tax incentives towards the current simplified tax system.

Principle 8. Highlight the largest beneficiaries of tax incentives for investment by specific tax provision in a regular statement of tax expenditures, where possible.

> The analysis of Ghana's tax expenditure landscape reveals that 15 largest "beneficiaries" take the vast majority, 93.2 %, of all VAT tax expenditures.

Principle 9. Collect data systematically to underpin the statement of tax expenditures for investment and to monitor the overall effects and effectiveness of individual tax incentives.

> Not enough data is collected in Tunisia to allow for systematic cost-benefit analyses and simulation modelling of tax incentives. Integration and leverage of common inter-agency data is challenging due differences in the classification systems, which lack common definitions and structure.

Principle 10. Enhance regional cooperation to avoid harmful tax competition.

> OECD is working with the SADC to strengthen investment policy framework at the regional level by defining common guidance across member states, including related to tax incentives. The project builds a SADC-wide mechanism to satisfactorily address the harmful tax competition.