A BRICS Response to BEPS: The View from Brazil on International Tax Reform

Canberra, Australia
August 6, 2014

Flavio Rubinstein
1. Introduction

2. BEPS and Developing Countries

3. Brazilian Response to BEPS

4. Conclusions
1. Introduction
BEPS Core Issues

- Intra-group financing
- Digital Economy
- Hybrid mismatches and tax arbitrage
- Transfer pricing
- Limited efficiency of anti-abuse rules
- Preferential tax regimes
BEPS Action Plan

- Deliverables: 15 actions scheduled to be finalized before Dec 2015
- Potential to initiate the most significant international tax reforms in decades
- Main principles: (i) coherence, (ii) substance e (iii) transparency
- Open discussion with various stakeholders
- Sense of urgency, with ambitious goals and very short timeframe
- BEPS named priority of Australian G20 presidency (2014)
<table>
<thead>
<tr>
<th>Action Point</th>
<th>Goal</th>
<th>Deadline</th>
<th>Action Point</th>
<th>Goal</th>
<th>Deadline</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Address the challenges of the digital economy</td>
<td>Sep/14</td>
<td>9</td>
<td>Assure that transfer pricing outcomes are in line with value creation: risks and capital</td>
<td>Sep/15</td>
</tr>
<tr>
<td>2</td>
<td>Neutralize the effects of hybrid mismatch arrangements</td>
<td>Sep/14</td>
<td>10</td>
<td>Assure that transfer pricing outcomes are in line with value creation: other high-risk transactions</td>
<td>Sep/15</td>
</tr>
<tr>
<td>3</td>
<td>Strengthen CFC rules</td>
<td>Sep/15</td>
<td>11</td>
<td>Establish methodologies to collect and analyze data on BEPS and the actions to address it</td>
<td>Sep/15</td>
</tr>
<tr>
<td>4</td>
<td>Limit Base Erosion via interest deduction and other financial payments</td>
<td>Dec/15</td>
<td>12</td>
<td>Require taxpayers to disclose their aggressive tax planning arrangements</td>
<td>Sep/15</td>
</tr>
<tr>
<td>5</td>
<td>Counter harmful tax practices more effectively, taking into account transparency and substance</td>
<td>Dec/15</td>
<td>13</td>
<td>Re-examine transfer pricing documentation</td>
<td>Sep/14</td>
</tr>
<tr>
<td>6</td>
<td>Prevent treaty abuse</td>
<td>Sep/14</td>
<td>14</td>
<td>Make dispute resolution mechanisms more effective</td>
<td>Sep/15</td>
</tr>
<tr>
<td>7</td>
<td>Prevent the artificial avoidance of PE status</td>
<td>Sep/15</td>
<td>15</td>
<td>Develop a multilateral instrument</td>
<td>Dec/15</td>
</tr>
<tr>
<td>8</td>
<td>Assure that transfer pricing outcomes are in line with the value creation: intangibles</td>
<td>Sep/15</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
2. BEPS and Developing Countries
International tax dodging & developing countries

- There is a lack of empirical evidence on how BEPS affects individual countries, in general and developing ones in particular.

- Developing countries are strongly affected by international tax dodging:
  - MNEs tax gap estimated at $104bi a year (OXFAM, 2014)
  - In many developing countries, MNEs are even more significant as a source of corporate income tax revenues than in developed countries.

- Developing countries are more reliant of corporate income taxes.
Revenue from the corporate income tax as percentage of total revenue

Source: IMF (2014)
BEPS Reports and developing countries

- The original report acknowledges that tax dodging is especially relevant for developing countries, where tax revenue is critical to foster long-term development.

- Besides, as OECD argues, “BEPS undermines the credibility of the tax system in the eyes of all taxpayers.”

- July, 2014 OECD Report on the impact of BEPS in low income countries: “BEPS actions for developing countries may need specific emphases or nuances.”

- BEPS Project is “not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income” (source vs. residence).
Is OECD the best forum choice?

- Critics say OECD most likely will not prioritize developing country concerns.
- Many developing countries are outspoken critics of the current allocation of taxing rights (favoring residence countries), of the OECD Model Tax Treaty and of the arm’s length principle.
- Role of alternative forums:
  - G20
  - IMF
  - UN
  - BRICs
Non-member, G20 countries (Argentina, Brazil, China, India, Indonesia, Russia, Saudi Arabia and South Africa) have been accepted as full members of OECD working parties on BEPS.

Consultations through regional meetings, organized in cooperation with regional or national organizations (ATAF, CIAT, etc.) and OECD’s Task Force on Tax and Development (100+ members)

July, 2014 OECD Report on the impact of BEPS in low income countries
Widest participation of developing countries; explicit “financing for development” mandate

UN Tax Committee decided to set up a subcommittee on BEPS
- Feedback from a developing country viewpoint
- Possible remedies for BEPS for developing countries, beyond the OECD project

Specific actions identified as especially relevant to source countries
- Action 4 – Limit base erosion via interest deductions and other payments
- Action 6 – Prevent Treaty Abuse
- Actions 8, 9 and 10 – Assure that TP outcomes are in line with value creation
- Action 11 – Methodologies to collect and analyze data on BEPS and the actions to address it
- Action 12 – Disclosure of aggressive tax planning arrangements
- Action 13 – Re-examine TP documentation
Heads of BRICS countries’ tax authorities met in 2013 and released a joint communiqué, to promote:

- Closer cooperation and coordination in tax administration
- Joint tax administration capacity building
- Concerns on tax base erosion and profit shifting
- Special mention to transfer pricing, treaty abuse, complex multi-layered structures, incomplete disclosure and fraudulent claims

BRICS countries are engaged with the OECD on the BEPS project.

But BRICS are have diverse (often conflicting) interests and hardly represent developing countries at large.
BEPS in the developing country context

1. The nature of cross-border tax planning may differ between developing and developed countries

2. Developing countries may lack the necessary legislative measures needed to address BEPS

3. Accessing relevant information is often difficult

4. Capacity building

5. Need for political buy-in as a prerequisite to making the legislative changes and resource commitment required to counter BEPS

6. Domestic tax incentives for development

7. Beyond BEPS: how should the tax pie be divided between developed and developing countries?
3. Brazilian Response to BEPS
FDI in Brazil

- US$ 63b (2013)
  - 7th largest FDI flow in the world
  - 47% of Latin America’s flow
  - Down 2% in 2012 and 2.9% in 2013

Source: World Investment Report (UNCTAD)
Brazilian FDI Sources

Source: Folha de S. Paulo, Dec 15, 2011; Brazilian Central Bank data
Brazilian FDI Sources

Source: Folha de S. Paulo, Dec 15, 2011; Brazilian Central Bank data
Brazil vs. aggressive international tax planning

- Brazilian tax authorities estimate that international tax planning generates 1/3 of the country’s tax gap.
- Rules to prevent abusive tax planning (transfer pricing, CFC, thin cap, higher WHTs for tax havens, disclosure for deductibility of expenses etc.).
- General anti-avoidance provision and substance over form approach.
- Targeted audits.
- TIEAs, tax treaties (small network so far) and Multilateral Convention on Mutual Administrative Assistance in Tax Matters.
- Sophisticated tax administration IT capabilities, but limited staff and funding.
After some bureaucracy, Brazil is now associated to the BEPS project

- On July, 2013 Brazilian Internal Revenue Service informed the Ministry of Finance and the Office of the Chief Counsel the intention of joining the BEPS project (Memo 892/2013-RFB/Gabin)

- However, since formal participation in BEPS requires payment (€ 50.700 a year), Congress would have to authorize it

- On October, 2013 OECD’s Business and Industry Advisory Committee met with representatives of Brazil’s tax authorities

- Congressional authorization finally came on June 18, 2014 (under Law 12.995)
General Brazilian tax policy concerns related to the BEPS action plan

- Administrative burden and compliance costs
- Taxpayers rights in tax information exchange procedures
- Role of “contributions” in corporate taxation and withholding at source
- Rigid constitutional tax framework and time-consuming legislative procedures for reforms
- Chances of massive tax litigation
- Tax incentives for investment and development
- Lack of negotiation culture and instruments between taxpayers and tax authorities
  - Obstacles to advance notice of aggressive tax planning and dispute resolution
Potential conflicts between Brazilian tax policies and the BEPS action plan

- **Extensive withholding taxation at source**
  - Income Tax + “contributions”
  - Brazil’s comment on Action 4: WHT on interest payments should be considered

- **Transfer pricing rules: Brazilian way vs. international practice**
  - Fixed margins, rigid methods, no general arm’s length principle

- **CFC rules: Brazilian way vs. international practice**
  - Broader: also for non-tax havens, affiliated companies and active income
  - Brazil’s comment on Action 3: CFC rules should include active income

- **Interpretation of tax treaties**
  - Tax authorities have tried to push their exotic treaty interpretation views as regulations

- **Deductibility rules on inter-company royalty payments**
  - Outdated and not arm’s length
Specific BEPS actions that Brazil wants to push

- Action 1 – Address tax challenges of the digital economy
- Action 3 – Strengthen CFC rules
- Action 4 – Limit base erosion via interest deductions and other payments
- Action 5 – Counter harmful tax practices more effectively, taking into account transparency and substance
- Action 7 – Prevent the artificial avoidance of PE status
- Actions 8, 9 and 10 – Assure that TP outcomes are in line with value creation
- Action 12 – Disclosure of aggressive tax planning arrangements
- Action 13 – Re-examine TP documentation

➢ Additionally: Constant improvement of risk analysis tools to detect abusive practices

Source: Comments from Brazil to the UN Questionnaire, April 2014
5. Conclusions
BEPS is a reality

- Is a perfectly coordinated, supra-national action on BEPS attainable? Perhaps not...

- Is the timeframe too short? Most likely yes...

**BUT...**

- BEPS could be beneficial for everyone

- Governments are communicating and trying to coordinate their approaches to aggressive international planning, which is good

- International taxation is now on the spotlight, which is also good

- Even if no progress towards fundamental reform is made, some relevant incremental changes can be realistically achieved
The BEPS Road Ahead for Developing Countries

- For developing countries, much needed tax reform goes beyond BEPS

- Within the context of BEPS, adequate safeguards and capacity building tools (resources and assistance) must be ensured for developing countries

- Diversity between “developing countries”, both in terms of socioeconomic features and administrative capacity, must be taken into account

  - Should they adopt a joint approach to take part in BEPS? As much as it would enhance their standing, it could homogenize the diversity for worse

- Time for serious consideration of a World Tax Authority?

- For BEPS, moving forward without taking into concern the interests of developing countries brings the risk of replacing one broken international tax system with another one just as broken (or even worse)…
The End...

Thank you so much!!!

Flavio Rubinstein
rubinstein@vrflaw.com.br
flavio.rubinstein@fgv.br