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The Impact of BEPS on Your Relationship with Customs Authorities

If you are moving or trading goods across borders, this topic should be of primary importance from both a Transfer Pricing and Customs perspective. There is potential for you to have Transfer Pricing and Customs exposures in your supply and value chains as a result of the OECD/G20 initiative on Base Erosion and Profit Shifting (BEPS).

BEPS is targeted at tax planning strategies that exploit gaps and mismatches in tax rules, to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.

BEPS is a significant issue for many jurisdictions regardless of their reliance on corporate income tax. By the end of 2015, tax jurisdictions will have the tools to ensure that profits are taxed where economic activities generating the profits are performed and where value is created, while at the same time give businesses greater certainty by reducing disputes over the application of international tax rules by standardising requirements. The deliverables consists of fifteen specific Action steps which will be released over a two year period which began in 2014. The Actions are listed in the following table.

2014 DELIVERABLES (RELEASED SEPT. 2014)		2015 DELIVERABLES	
Action 1:	Address the Tax Challenges of the Digital Economy	***Action 3:***	Strengthen Controlled Foreign Corporation Rules (CFC Rules)
Action 2:	Neutralise the Effects of Hybrid Mismatch Arrangements	***Action 4:***	Limit Base Erosion via Interest Deductions and other Financial Payments
Action 5:	Counter Harmful Tax Practices more effectively, taking into account transparency and substance.	***Action 7:***	Prevent the Artificial Avoidance of Permanent Establishment Status (PE)
Action 6:	Prevent Treaty Abuse	***Action 9:***	Assure that Transfer Pricing Outcomes are in Line with Value Creation/Risks and Capital
Action 8:	Assure that Transfer Pricing Outcomes are in Line with Value Creation/ Intangibles	***Action 10:***	Assure that Transfer Pricing Outcomes are in Line with Value Creation/Other High-Risk Transactions
Action 13:	Re-examine Transfer Pricing Documentation	***Action 11:***	Establish Methodologies to Collect and Analyse Data on BEPS and the Actions to Address
Action 15:	Develop a Multilateral Instrument	***Action 12:***	Require Taxpayers to Disclose Aggressive Tax Planning Arrangements
		Action 14:	Make Dispute Resolution Mechanisms More Effective

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To provide you with an indication of the potential impact these deliverables can have we will focus on just two of the Actions.

Action 13 - "Re-examine Transfer Pricing Documentation", calls for a three-tiered approach for Transfer Pricing documentation, and contains some very interesting changes that impacts your relationship with importing Customs authorities.

The three-tiered structure consists of:

- A "master file" containing standardised information relevant for all Multinational Enterprise (MNE) group members;
- A "local file" referring specifically to material transactions of the local taxpayer; and
- A country-by-country (CbC) report containing certain information relating to the global allocation of the MNE's income and taxes paid together with certain indicators of the location of economic activity within the MNE group.

Each of the above documents will be a source of information about your business globally and also within each jurisdiction. The following is an example of some of the information that will be required:

- Organisational structure – Chart illustrating the MNE's legal and ownership structure as well as geographical location of all operating entities;
- Description of the MNE's business including:
  - » Important drivers of business profit;
  - » A description of the supply chain for the group's five largest products and/or service offerings by turnover plus any other products and/or services amounting to more than five percent of group turnover. The required description could be in the form of a chart or diagram;
  - » A list and brief description of important service arrangements between members of the MNE group, other than research and development (R&D) services, including a description of the capabilities of the principal locations; and
  - » Providing important services and transfer pricing policies for allocating services costs and determining prices to be paid for intra-group services;
- MNE's intangibles;
- MNE's intercompany financial activities; and
- MNE's financial and tax positions.

The standardised information in the "master file" will provide a total view of your global operations and will most likely be prepared by the headquarters or regional headquarters and clearly identifies payment flows, discloses royalties, fees and other monies paid or received by an entity within a global business. It is very possible that such information may be shared by revenue generating authorities, especially inland revenue and Customs, within the same jurisdiction and across jurisdictions. There are already many instances of Customs working with inland revenue and other authorities (e.g., commercial crimes or the Police) to audit businesses in many jurisdictions.

In the US and EU, where the concept of "first-sale" is permitted under specific conditions, your total supply and value chains may be made transparent to Customs. For each entity involved, the number of employees and the turnover of those entities will need to be disclosed. If, under current first sale transactions, that "first-sale" is to a company that has no actual employees, then that will be discoverable by Customs and subject to further scrutiny on current and past import transactions using the "first-sale" price for duty calculations. For those MNC's that have restructured their operations and set up National Sales Centres or similar entities, how are all the entities within that supply chain staffed? If it is minimal for the amount of turnover, then you may have both a tax and customs problem because for customs purposes there must be substance to an entity through which payments are flowing.

Action 7 to "Prevent the Artificial Avoidance of Permanent Establishment Status (PE)" also has a potential Customs impact for some businesses. If you export goods to another country where you do not have a physical presence or a PE and use an agent as the importer of record (IOR), the sales made by you directly to your end customers (with instructions on fulfilment and delivery given to your IOR agent), could create potential exposures from a Customs perspective. Customs, in many countries have allowed this type of transaction mainly based on the fact that the establishment of this type of trade is compliant with the direct tax laws and does not create a PE situation under those laws. If Action 7, which is to be released this year, makes changes that make this type of trade one with a PE exposure from a direct tax perspective, then we believe that Customs will close this type of transaction and require the owner of the goods to establish a physical presence in order to be the importer of record.

Implementation by Jurisdictions

With more jurisdictions adopting and implementing the 15 BEPS Deliverables, businesses have to consider BEPS very carefully when planning direct and indirect tax structures in the future and also to review current structures for possible exposures.

The Inland Revenue Authority of Singapore (IRAS) has implemented changes to its transfer pricing rules to reflect some of these 2014 BEPS Deliverables. Thailand has also just released a notice that it intends to introduce similar changes very soon. Thai Customs officers have received extensive training on transfer pricing from a direct tax perspective and on BEPS. They also make use of the services of the direct tax authorities audit divisions in order to extend their reach. Indonesia is also considering new transfer pricing legislation.

We expect more jurisdictions to be in line with the BEPS Deliverables over the next two years or so and those, like Singapore, which have implemented changes early, may also do further changes over the next two years.

For more information about the topics raised in this Trade Alert or if you wish to have your current structures reviewed in light of the potential change, please contact:

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