A "taxing" situation

The evolution and impact of OECD driven Base Erosion and Profit Shifting (BEPS) Action Plan from a GCC perspective

As international tax rules were written decades ago, there have been fundamental changes in the global landscape due to globalization and digitalization of economy. Hence, it is important for all government authorities and international organizations to address the issue of double taxation, profit shifting, and tax evasion. With support from G20 nations, the Organization for Economic Cooperation & Development (OECD) has taken joint action to increase transparency and exchange of information in tax matters, and to address weaknesses of the current global tax system that lead to tax leakages for tax authorities.

Following the 2008 economic crisis, western nations made "taxation" a priority topic and have since led the fight against profit erosion. Base Erosion and Profit Shifting (BEPS) refers to strategies used by a company in attempt to exploit gaps and mismatches in tax rules to move profit to a low tax jurisdiction. As such, the OECD initiated the BEPS Action Plan (with the support of all Inclusive Framework (IF) member countries), which has taken centre stage in addressing the challenges of the global economy.

Due to lack of adequate measures in place, it is estimated that annual tax revenues of approximately US$100 billion are lost due to BEPS creating huge tax loopholes in the system based on OECD findings. Keeping this in mind, the objective of the BEPS framework is to seek consensus building amongst OECD member countries and G20 nations. Ultimately, the BEPS framework's goal is to implement policies and tax rules that don't facilitate the shifting of corporate profits away from where the real economic activity and value creating is taking place. Back in 2015, the OECD identified 15 actions along three key pillars: introducing coherence in the domestic rules that affect cross-border activities; reinforcing substance requirements in the existing international standards; and improving transparency, as well as certainty.

This comprehensive 15-point BEPS Action Plan would provide clarity and transparency in the international tax arena. The 15 points of the BEPS Action Plan are as follows:

- **Action 1:** Addressing the tax challenges of the digital economy
- **Action 2:** Neutralizing the effects of hybrid mismatch
- **Action 3:** Designing effective controlled foreign company rules
- **Action 4:** Limiting base erosion involving interest deductions and other financial payments
- **Action 5:** Countering harmful tax practices more effectively, taking into account transparency and substance
- **Action 6:** Preventing the granting of treaty benefits in inappropriate circumstances
- **Action 7:** Preventing the artificial avoidance of permanent establishment status
- **Actions 8-10:** Aligning transfer pricing outcomes with value creation
- **Action 11:** Measuring and monitoring BEPS
- **Action 12:** Mandatory disclosure rules
- **Action 13:** Guidance on transfer pricing documentation and country-by-country reporting
- **Action 14:** Making dispute resolution mechanisms more effective
- **Action 15:** Developing a multilateral instrument to modify bilateral tax treaties

The BEPS package of measures represents the first substantial renovation of the international tax rules in almost a century. Once the new measures become applicable, it is expected that profits will be reported where the economic activities that generate them are carried out and where value is created. The BEPS package is designed to be implemented via changes in domestic law and practices, and via treaty provisions, with negotiation for a multilateral instrument under way.

Out of 15 BEPS action items, the four minimum ones are Action 5, Action 6, Action 13, and Action 14, which all IF member countries have to meet and are subject to annual peer review by the OECD. Implementation of these recommendations aims to tackle tax avoidance, improve

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the coherence of international tax rules, and ensure a more transparent tax environment with the implementation of these specified actions. The IF currently comprises 140 countries, including USA, Japan, Latin America, and Asia Pacific, as well as various other geographic regions. Although these tax policies introduced by G20 and OECD IF member countries are the soft law, and will only be hard law once transposed into domestic law by member countries, they are gaining momentum in today's global economy as not joining the bandwagon can lead to name shame and potential loss of reputation.

From a Middle East perspective, almost all GCC countries (except for Kuwait which is not part of the IF membership yet) are playing crucial roles in terms of meeting the four minimum BEPS actions and making improvements in their regime per the recommendations provided by the OECD peer review committee. For instance, back in October 2021, Qatar's Ministry of Finance issued guidance concerning Economic Substance Regulations (ESR), requiring certain "qualifying entities" that carry on specified activities to demonstrate economic substance in Qatar from November 4, 2021 if they want to benefit from a preferential tax regime. This required all relevant entities in Qatar to assess whether they would fall into ESR scope or not and take necessary steps to comply. These welcoming measures by the Qatar Tax Authority are to address the OECD's recommended issues with regards to BEPS Action 5. As for the other minimum action items, based on the OECD's website, Qatar has so far met all the criteria of the OECD peer committee.

Likewise, when it comes to OECD peer review for the UAE, it has also been found to be largely compliant in terms of exchange of information upon request (EOIR), and its review of effectiveness in practice of automatic exchange of information (AEOI) is also on track. As for the other action item update per OECD findings, the UAE is compliant in terms of BEPS Action 5 (Existence of Harmful Tax Practice); it is going through Action 6 review (Preventing Treaty Abuse); there is a proper legal framework in place when it comes to Action 13 (Guidance on Country-by-Country reporting); and finally, Action 14 (Effective Dispute Resolution) has been reviewed and some recommendations have made by the OECD. Last but not least, along with the majority of GCC countries, the UAE also participated in the OECD agreement back in October 2021 regarding the two-pillar plan to address tax challenges arising from the digitalization of the economy.

From wider GCC perspectives, there have also been positive improvements and developments when it comes to OECD peer review in terms of minimum BEPS action items. In addition, beyond the four minimum BEPS action items, as the majority of the EU and other remaining OECD countries have also started to implement the remaining 11 BEPS action items in some respect (although not mandatory), GCC tax authorities should start envisioning how to bring these new rules in the domestic legislations to be aligned with international tax regulations. This could pose as adopting the principles of anti-tax avoidance directives, controlled foreign company (CFC) rules, and addressing hybrid mismatch rules, as the GCC wants to attract foreign direct investment (FDI) in the near future, and make it easy from tax policy perspectives.

But in the meantime, it is encouraging to see our GCC IF member countries actively participating in the two-pillar plan agreement to address the tax challenges arising from the digitalization of the economy in line with BEPS Action 1. This certainly shows the willingness and ability of wider GCC tax authorities to have tax policies and regulations in line with OECD standards, which is certainly welcoming news in today's global tax landscape.

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