

Global Business Reaction to BEPS

Survey reveals impact of BEPS on the middle market.





BACKGROUND

WHAT IS BEPS?

Base Erosion and Profit Shifting (BEPS) refers to the erosion of national taxation bases and the artificial shifting of profits between jurisdictions resulting generally from the inability of industrial-age tax laws to respond to the digital economy, and specifically from the existence of unintended gaps and mismatches between different countries' tax systems.

In 2013, the OECD and the G-20 launched the BEPS Project, which aims to provide governments with ways to close perceived gaps in existing international tax rules that can be used by multinational enterprises to make profits disappear for tax purposes, or to shift profits to low-tax jurisdictions where these enterprises have little or no real activity, allowing them to pay low or no corporate taxes. The project action plan identified 15 Action Items aligned along three fundamental pillars:

- Establishing **coherence** in the domestic rules that affect cross-border activities.
- Reinforcing **substance** requirements in the existing international standard.
- Improving **transparency**.

In October 2015, the OECD presented the final package of measures on the 15 Action Items intended to initiate a comprehensive and coordinated reform of international tax rules. These measures include:

- Changes relating to bilateral tax treaties, including a minimum standard to prevent treaty shopping.
- Revisions to the transfer pricing rules, which determine the tax treatment of intra-group transactions, to focus on the substance of the transactions rather than their legal form.
- An update of the framework for evaluating the potential harmful effects of preferential regimes introduced by governments, with a specific focus on patent boxes and tax rulings.
- Model domestic law measures to counter BEPS.

ABOUT THE SURVEY

In early 2016, RSM commissioned Euromoney Institutional Investor to conduct an online survey to their subscriber base of global businesses. From 762 respondents, the data pool was reduced to 494 to allow the report and findings to be based only on the responses of those who reported familiarity with BEPS. This helped ensure the conclusions drawn here are from a survey pool educated on BEPS and its potential impact on their organisation. This was a global survey: 46 percent of the respondents were from Europe, 41 percent from North America, and the remaining 13 percent divided among Latin America, Asia, the Middle East and Africa. Respondents represented companies with a wide range of revenues: 47 percent were large companies with revenues greater than US\$1 billion, 42 percent were middle market companies with revenues between US\$50 million and US\$1 billion, and 11 percent were small companies with revenues of less than US\$50 million. Respondents also had various roles within their companies: 30 percent were tax executives, 21 percent were financial executives, 6 percent were heads of companies, and 43 percent were in other senior decision-making roles.

EXECUTIVE SUMMARY

INCREASED COSTS AND UNCERTAINTY

The BEPS Project will have direct and significant consequences for all internationally operating companies. It will increase compliance costs and global effective tax rates and is creating considerable strategic uncertainty. Many companies will need to make changes to their corporate structure; these changes may be significant. These are among the findings of a recent survey commissioned by RSM and conducted by *Euromoney Institutional Investor* in early 2016. More than 750 executives in leadership roles at multinational enterprises gave us their insights on the perceived risks concerning, and sentiments about, the BEPS Project.

The BEPS Project, undertaken by the Organisation for Economic Co-operation and Development (OECD) and the G-20¹ countries, will result in some of the most significant changes in international taxation in decades. More than 80 developing countries and other economies outside the OECD and the G-20 have participated directly in technical working groups and shaped the outcomes through regional consultations and thematic global forums. There is no doubt that the current BEPS Action Plan proposals will present substantial challenges for companies with multinational operations.

THE BEPS PROJECT WILL HAVE A SIGNIFICANT IMPACT ON THE MIDDLE MARKET

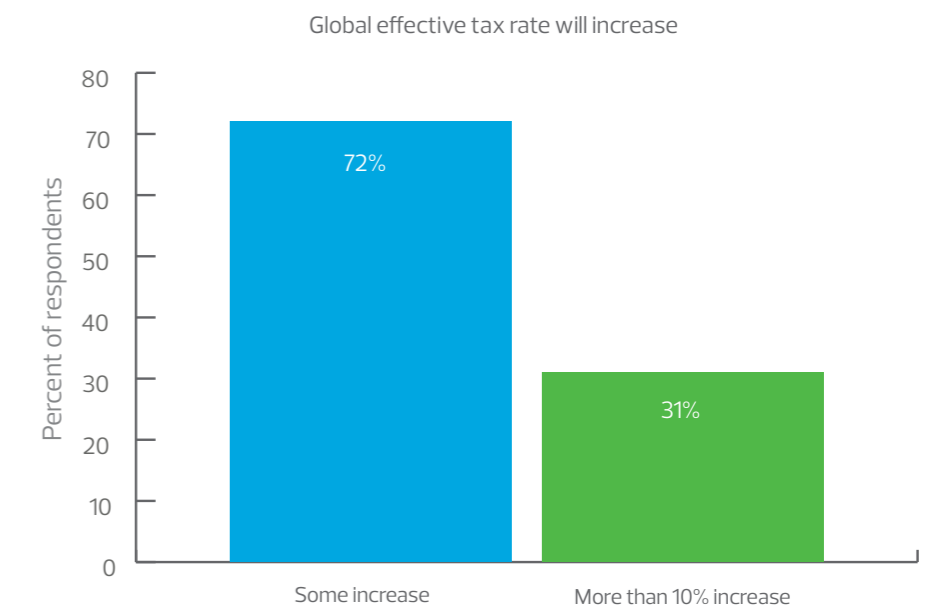
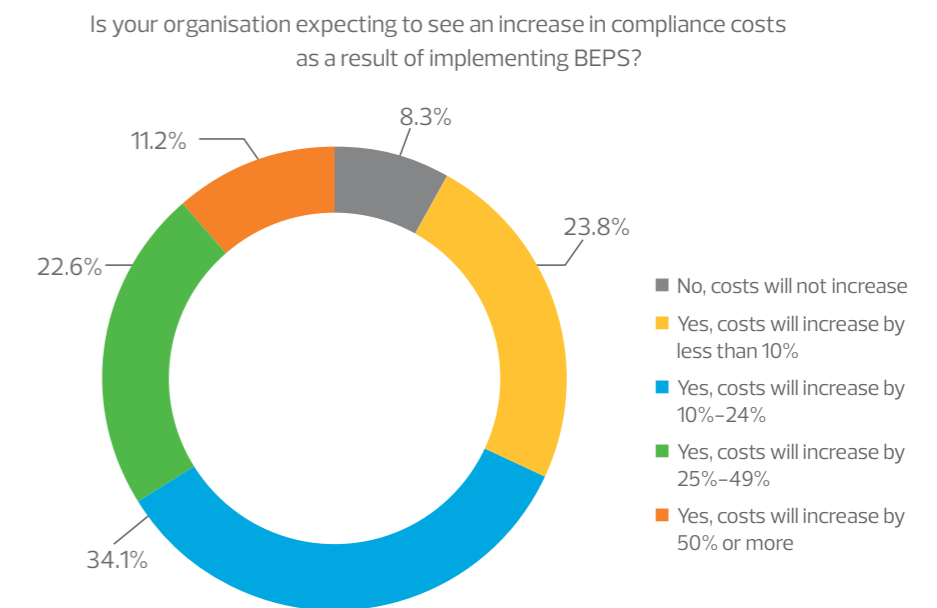
When the BEPS Project was initiated in 2013, many assumed that it would have limited impact on middle market companies. This is clearly not the case. Middle market companies (revenues ranging from US\$50 million to US\$1 billion) and large companies (revenues of US\$1 billion or more) report very similar expectations concerning anticipated:

- increases in compliance costs
- increases in effective global tax rates
- uncertainty regarding business strategy
- changes to corporate tax structures
- activities necessary to align with new transfer pricing and permanent establishment rules

By comparison, respondents from small companies (less than US\$50 million in revenue) were less likely to anticipate increases in compliance costs and tax rates, reported lower uncertainty and were less likely to anticipate changes to their corporate structures.

COMPLIANCE COSTS AND GLOBAL EFFECTIVE TAX RATES WILL INCREASE

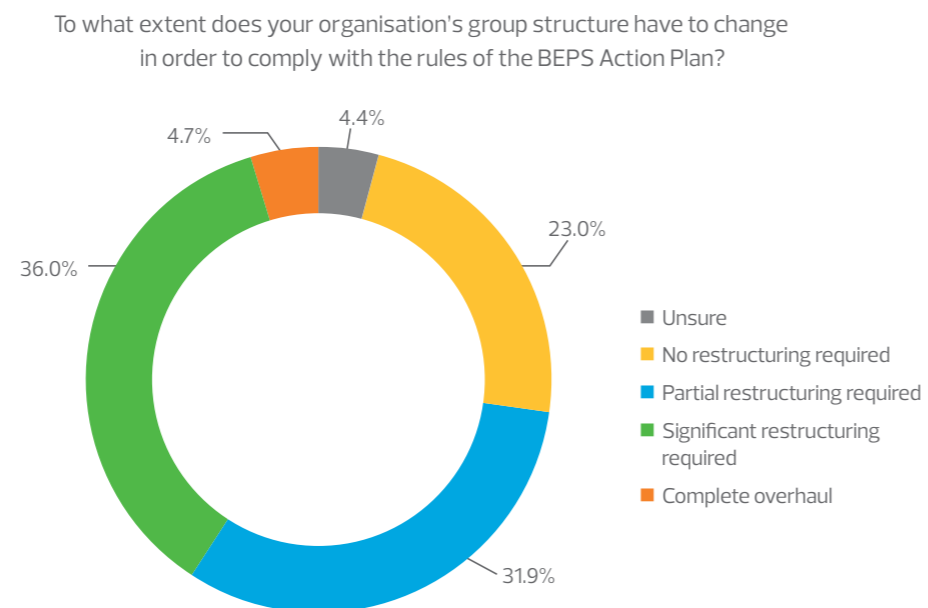
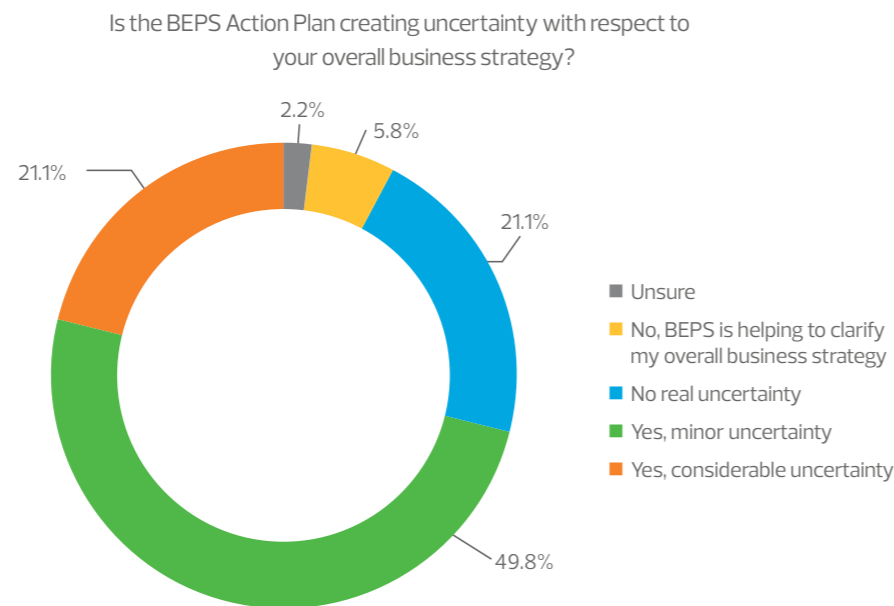
The vast majority of respondents, 68 percent, expect their compliance costs to increase by at least 10 percent, with 34 percent expecting those costs to increase by 25 percent or more. Most also anticipate an increase in their worldwide effective tax rate, with 72 percent expecting some increase and 31 percent expecting an increase of more than 10 percent.



¹ A group of finance ministers and central bank governors from 19 of the world's largest economies and the European Union. Members are the European Union and the following 19 countries: Argentina, Australia, Brazil, Britain, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey and the United States. Together, the G-20 nations represent approximately 85 percent of the global economy.

THE BEPS PROJECT IS CREATING STRATEGIC UNCERTAINTY AND WILL LIKELY MEAN CHANGES TO CORPORATE STRUCTURE

More than 70 percent of respondents report that BEPS is causing uncertainty in their business strategies. Companies also anticipate having to change their group structures, with 73 percent expecting to make some change and 41 percent planning on making a significant change or even a complete overhaul of their structure.



The BEPS Project seeks to establish a more consistent, transparent and fair standard for global taxation that better ensures taxes are paid in the appropriate amounts and in the appropriate jurisdictions.

MOST AGREE CHANGE IS NECESSARY BUT SEE BEPS AS A WORK IN PROGRESS RATHER THAN THE FINAL SOLUTION

The majority of respondents, 69 percent, believe it is necessary to implement some form of global taxation standards. However, 61 percent felt the BEPS Action Plan moderately satisfies, slightly satisfies or does not at all satisfy the primary objective of ensuring tax is paid where profits are created, and only a third (35 percent) felt it would largely or completely satisfy the objective of leveling the international playing field. However, overall, while conscious of the flaws in the BEPS process, our survey respondents seem well disposed, or at least open minded, to the benefits it could deliver.

THE BEPS PROJECT WILL HAVE A SIGNIFICANT IMPACT ON MIDDLE MARKET COMPANIES

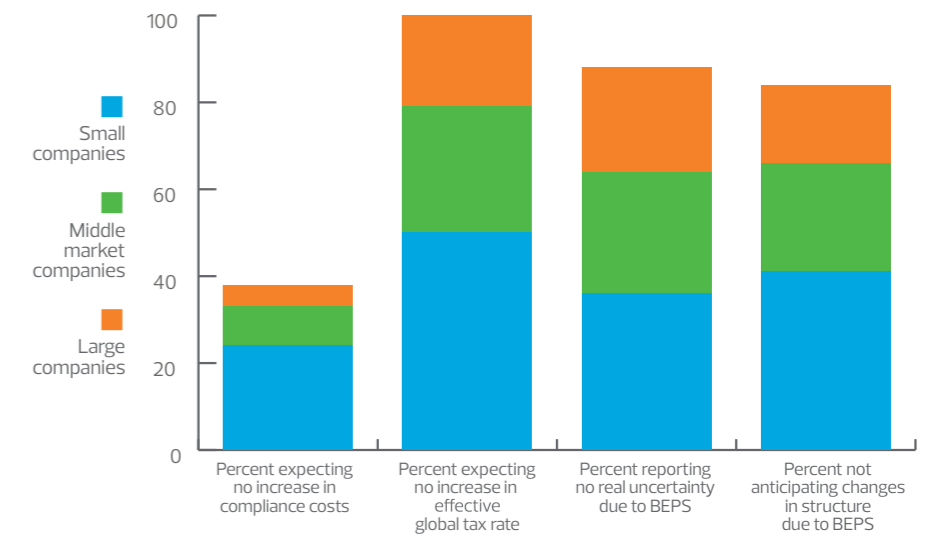
Middle market and large companies share concerns, but even small companies face challenges.



When the BEPS Project began, many thought it would have a minimal impact on middle market companies. Yet, respondents to the survey indicate the proposals will affect the middle market almost as much as large companies. Small companies anticipate being less affected, but even they are far from immune. Consider these findings:

- More than twice as many small-company respondents do not expect an increase in compliance costs as compared to middle market or large-company respondents.
- Small-company respondents were at least twice as likely as middle market or large company respondents to expect no increase in their effective global tax rate due to the BEPS Project.
- Small-company respondents were more likely to report no real uncertainty due to the BEPS Project than middle market or large companies.
- Small-company respondents were also far more likely to not anticipate a change in corporate structure due to the BEPS Project than respondents from middle market or large companies.

Middle-market and large companies anticipate similar cost, uncertainty and restructuring issues

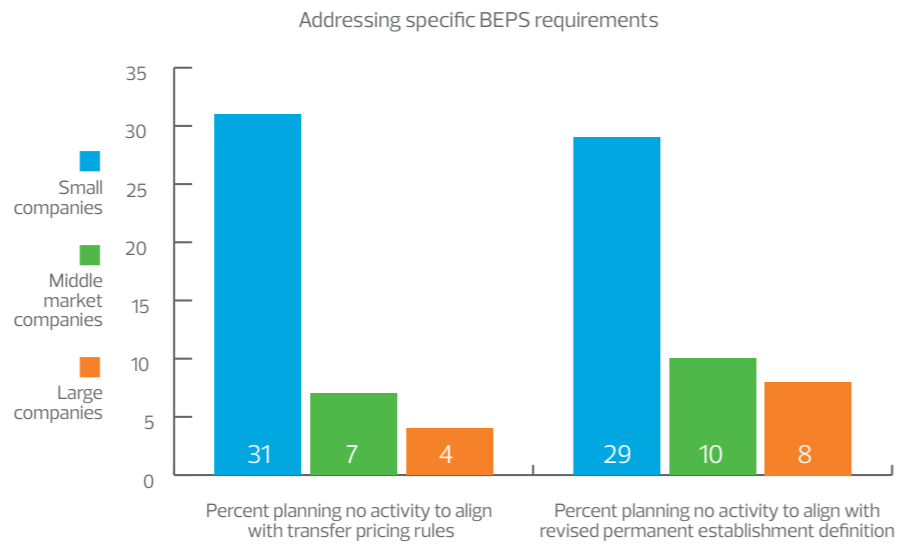


The differences in responses between large and middle market companies versus small companies may be due to a combination of different circumstances and a different level of engagement with and knowledge of the likely effects of the BEPS Project. Many smaller companies have simpler global structures, with no holding companies or branches. Instead, they operate through directly owned, locally incorporated subsidiaries. Their borrowing levels are constrained by their size, and their intellectual property assets are minimal. In such cases, BEPS is not as significant a concern as it is for larger, more complex organisations. However, not surprisingly, smaller companies also may simply be less informed concerning BEPS and its effects. Just three years ago, many middle market companies thought BEPS would target only large, multinational enterprises, but, as they have tracked progress of the BEPS Project, they now see that they, too, will be affected. As small companies learn more, their level of concern may increase.

ALIGNMENT WITH AND ABILITY TO ADDRESS SPECIFIC BEPS REQUIREMENTS

Similarities between middle market and large company results extended to their reported alignment with and concerns about specific BEPS requirements. There were, again, sharp differences between middle market and large-company responses and those from small-company respondents.

- Only 7 percent of middle market respondents and 4 percent of large-company respondents have no activity planned to align themselves with the transfer pricing rules, while 31 percent of small companies have no plans.
- Only 10 percent of middle market respondents and 8 percent of large-company respondents have no activity planned to align themselves with the revised permanent establishment definition, while 29 percent of smaller companies have no plans.



Survey results show that middle market and large-company respondents share the same challenges when it comes to the BEPS Project, and when compared to small-company respondents, they also tend to share the same strengths. For example:

- When asked to rate the challenges associated with various aspects of the permanent establishment test, small company respondents were more likely to indicate the challenges would be difficult/very difficult for their organisation than middle market and large-company respondents.
- When asked about the difficulty of preparing for aspects of the new country-by-country reporting standards, small company respondents were far more likely to respond that the issues were largely or very challenging when compared to middle market or large-company respondents.

Large and middle market companies better prepared for country-by-country reporting and permanent establishment rules

	Small company respondents	Middle market company respondents	Large company respondents
In country-by-country reporting, the percent reporting it very/largely challenging to:			
Bring together local and global data across the organisation	45	33	33
Ensure confidentiality of sensitive information	57	33	36
Procure the right technology to create the appropriate reporting system	51	30	28
Concerning aspects of the permanent establishment definition, percent of respondents reporting it very difficult/difficult to:			
Comply with the principal purposes test	41	32	26
Comply with anti-fragmentation rules	34	32	23
Assess viability of preparatory/auxiliary exemptions	41	31	25
Review commissionaire structures	37	27	24

Respondents to the survey indicate that the proposals will affect the middle market almost as much as large corporates.

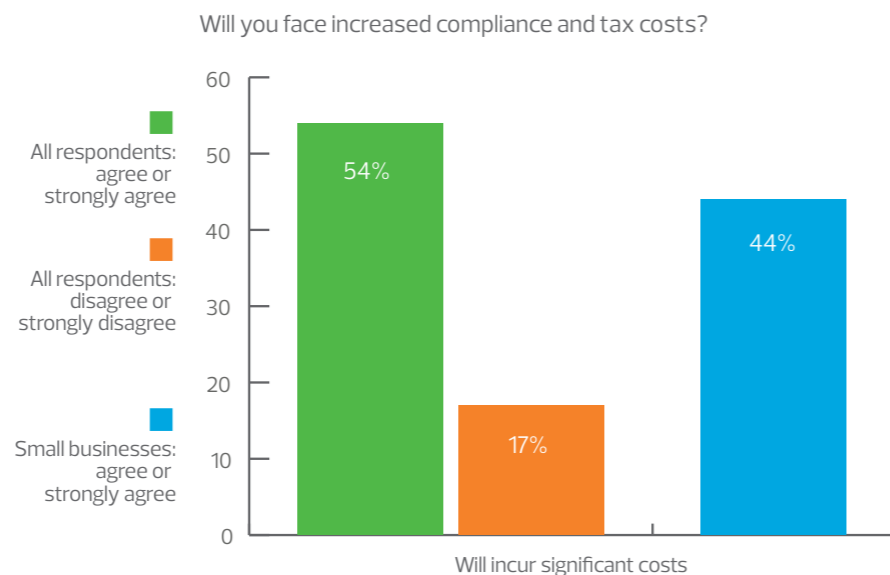


THE BOTTOM LINE ON BEPS: HIGHER COSTS. BUT WHO WILL PAY?

Most companies expect increased compliance and tax costs.

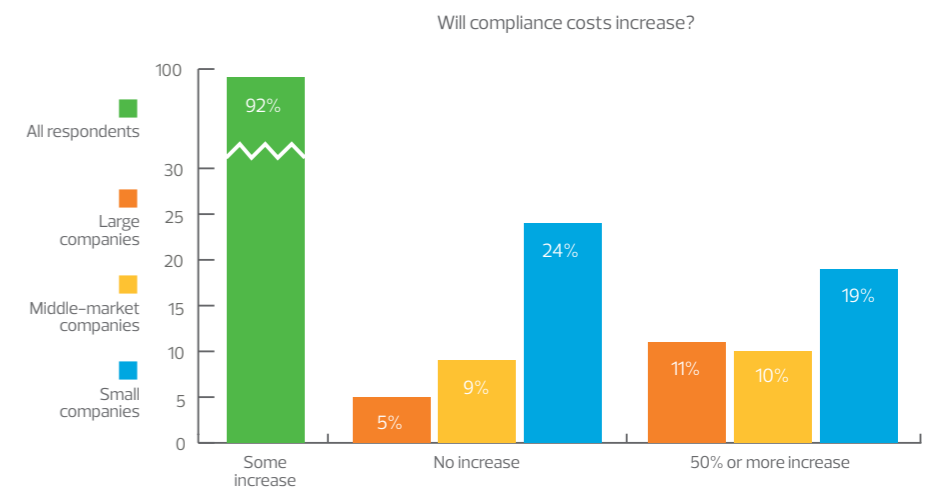


More than half of respondents (54 percent) either agreed or strongly agreed that their organisations would incur significant costs by complying with BEPS Action Plan proposals. Only 17 percent disagreed or strongly disagreed. Small-company respondents were more likely than middle market or large-company respondents to disagree or strongly disagree with that statement, but even among small companies, 44 percent of respondents agree or strongly agree that they face significant costs.



COMPLIANCE COSTS ARE EXPECTED TO INCREASE

Increased costs due to the BEPS Project are anticipated to include both increased compliance costs and increases to respondents' overall global effective tax rates, as the charts below demonstrate. Again, there were differences between small-company respondents and respondents from middle market or large companies. Overall, 92 percent of respondents expect some increase in compliance costs, with 68 percent expecting an increase of at least 10 percent and an impressive 34 percent expecting costs to increase by more than 25 percent. Small-company respondents were almost twice as likely as middle market and large-company respondents to expect the greatest increase in compliance costs, with 19 percent of them expecting increases of 50 percent or more, versus only 10 percent of middle market companies and 11 percent of large-company respondents.



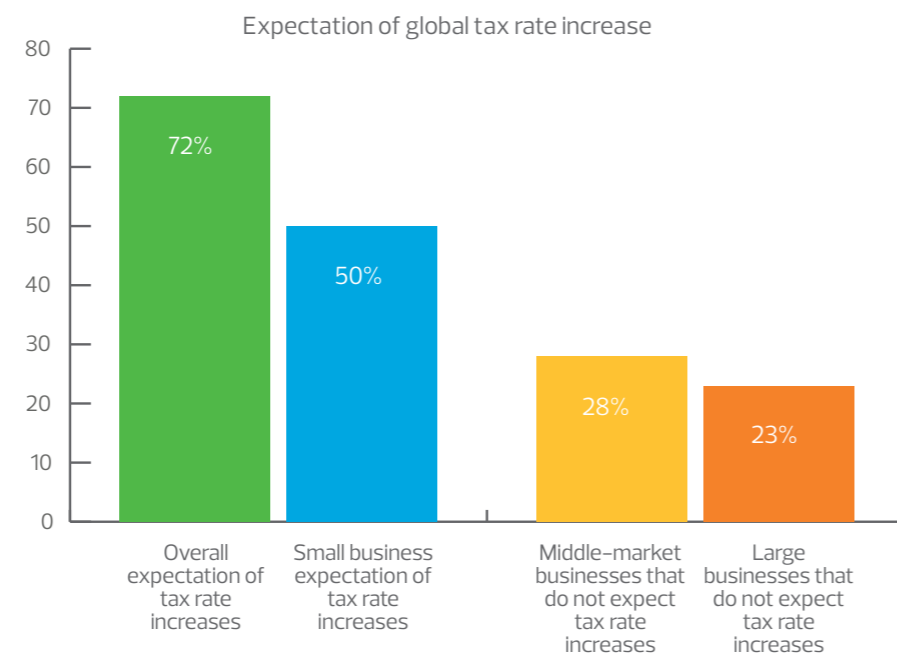
“The main compliance burden will be the preparing of additional transfer pricing documentation to comply with the master file and local file obligations. Due to the tightening of the rules on interest deductions and tax treaties, we expect to increase our global tax expense and our exposure to scrutiny from tax authorities.”

Head of Tax, Global Investment Management Company

It is not surprising that the majority of businesses foresee an increase in compliance costs as a result of the BEPS Project given the widespread changes to legislation and tax administration that will result. Compliance with the new transfer pricing documentation rules is just one obvious example of a new compliance cost. A key question is whether compliance costs will rise only temporarily during the transition period or whether the increase will be more permanent. Once businesses have acclimated to the new environment, compliance costs may settle into a steady-state mode. On the other hand, if there is a dramatic increase in tax administration audits and challenges or inconsistent application of the action plan principles and recommendations, heightened compliance costs may be more permanent.

RESPONDENTS ANTICIPATE INCREASES IN THEIR WORLDWIDE EFFECTIVE TAX RATES

There are also stark differences in expectations about increases in worldwide effective tax rates of small companies as compared to respondents from middle market and large enterprises. Overall, 72 percent of respondents expect an increased tax liability, but 50 percent of small-company respondents do not expect their overall effective tax rate to increase. Comparatively, only 28 percent of middle market companies and 23 percent of large companies do not expect an increase.



“There is increased uncertainty and compliance costs. The question is not if we will pay more tax, but where that tax is going to be, and how do we avoid double taxation?”

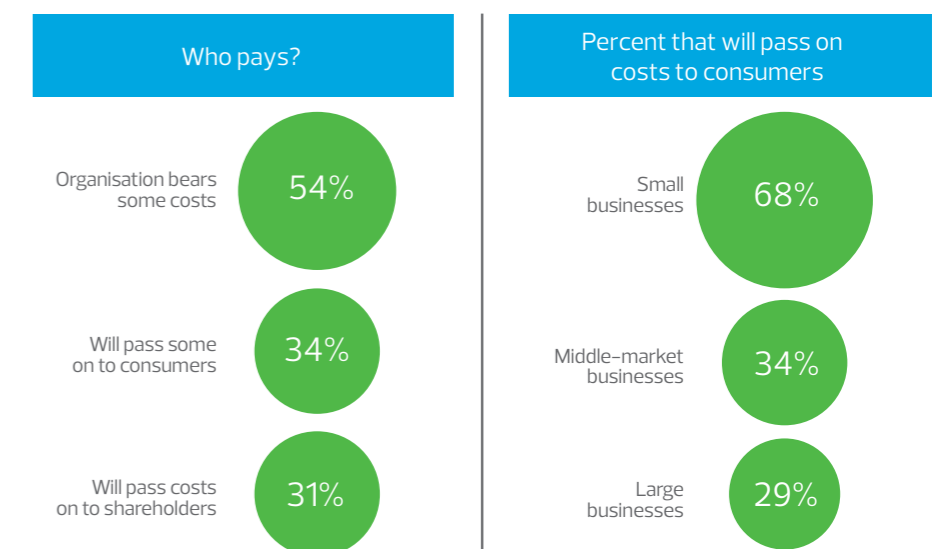
Global Tax Director, Global Telecommunications Company

Clearly, many businesses are concerned that the BEPS Project will create a harsher compliance environment with fewer planning opportunities, more tax administration challenges and increased risk of double taxation. But the move toward lower corporate tax rates as countries cut taxes to attract investment may more than offset the upward pressure on effective tax rates caused by the BEPS Project. In addition there is anecdotal evidence that many groups may take the opportunity to reassess the potential of substance-based transfer pricing planning now that other tax cost schemes or structures are generally less attractive. Therefore, if tax rates are falling and tax cost management is still possible, the BEPS Project may not cause the higher effective tax rates that many businesses fear.

WHO WILL PAY?

When asked how they expected to manage the costs resulting from the BEPS Project, 54 percent of respondents indicated that their organisation will bear some of the cost, 34 percent indicated that they will pass some of the cost on to customers, and 31 percent anticipated passing costs on to their shareholders. When asked about passing costs along to customers, 68 percent of small-business respondents reported that they were likely or highly likely to do so versus only 34 percent of middle market and 29 percent of large-company respondents.

Managing costs of BEPS



THE BEPS PROJECT IS CREATING UNCERTAINTY AND WILL LIKELY MEAN CHANGES TO CORPORATE STRUCTURES



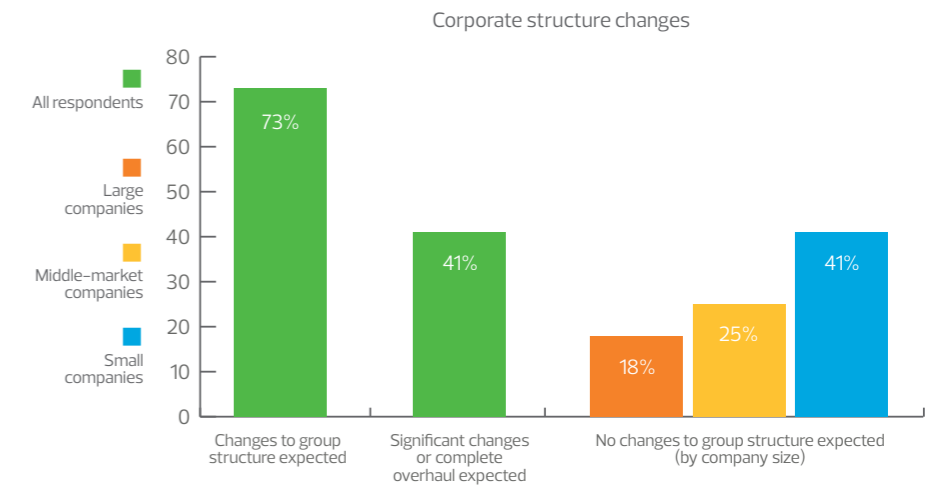
Most companies anticipate changes to their structure; many plan major changes.

The BEPS Project is creating considerable uncertainty among respondents concerning their corporate strategy. Overall, 71 percent of respondents indicated that the BEPS Project creates some degree of uncertainty, with 21 percent reporting considerable uncertainty. Respondents from smaller companies reported a lower level of uncertainty, with 55 percent expressing some degree of uncertainty versus 70 and 75 percent of middle market and large companies, respectively.



CHANGES TO CORPORATE STRUCTURE LIKELY

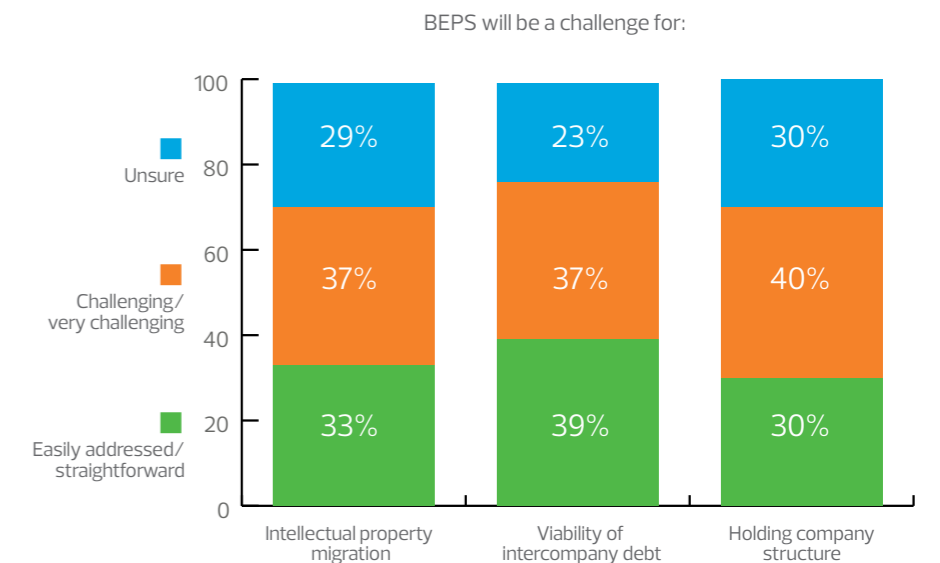
The vast majority of respondents, 73 percent, anticipate having to make changes to their group structure as a result of new BEPS-related requirements, with 41 percent expecting to institute significant changes or a complete overhaul. Again, there were sharp differences in responses from middle market and large companies versus small companies: 41 percent of small-company respondents reported no anticipated changes to their group structure versus 25 percent of middle market respondents and 18 percent of large-company respondents.



Respondents were asked how challenging it will be to address three specific corporate structure issues:

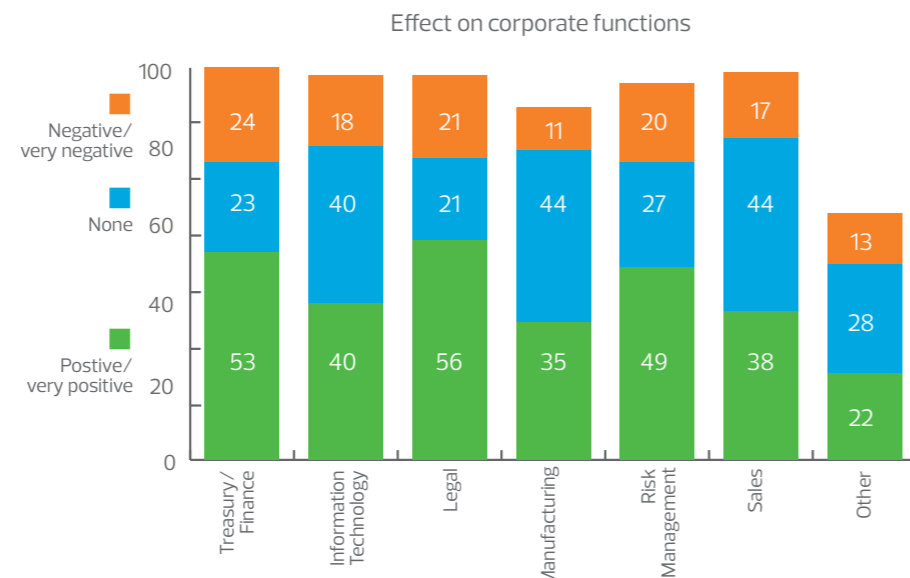
- Intellectual property migration strategies.
- Viability of intercompany debt.
- Holding company structures.

Overall, respondents were fairly evenly divided concerning the difficulty associated with each. Roughly equal numbers of respondents found these issues to be either easily satisfied or straightforward as compared to those finding the issues either challenging or very challenging. Highlighting the uncertainty that the BEPS Project is causing for many organisations, a significant number of respondents were unsure how hard these challenges would be to address.



LITTLE NEGATIVE EFFECT ANTICIPATED ON CORPORATE FUNCTIONS

When asked about the impact the BEPS Action Plan would have on specific corporate functions, respondents were largely optimistic. In every case, expectations were more positive than negative. Unlike with the responses to many other questions, there were not consistent, significant differences between responses from small companies and those from middle market and large companies.



BE PREPARED FOR CHANGE

BEPS could have a profound impact on a company's corporate structure. For example, traditional approaches companies have used to avoid creating a taxable presence may no longer work, and companies may have to think about how to change their business activities in order to avoid having tax and return filing obligations where they had none before. In addition, companies may have to review their capital structures to determine whether any debt should be restructured (or paid down) to avoid interest expense disallowance. Companies should also review their treaty positions since BEPS may change the standards used to determine eligibility for treaty benefits.

BEPS could have a profound impact on a company's corporate structure.



TOWARD A GLOBAL TAXATION STANDARD: ARE THE BEPS ACTION PLAN PROPOSALS THE RIGHT APPROACH?



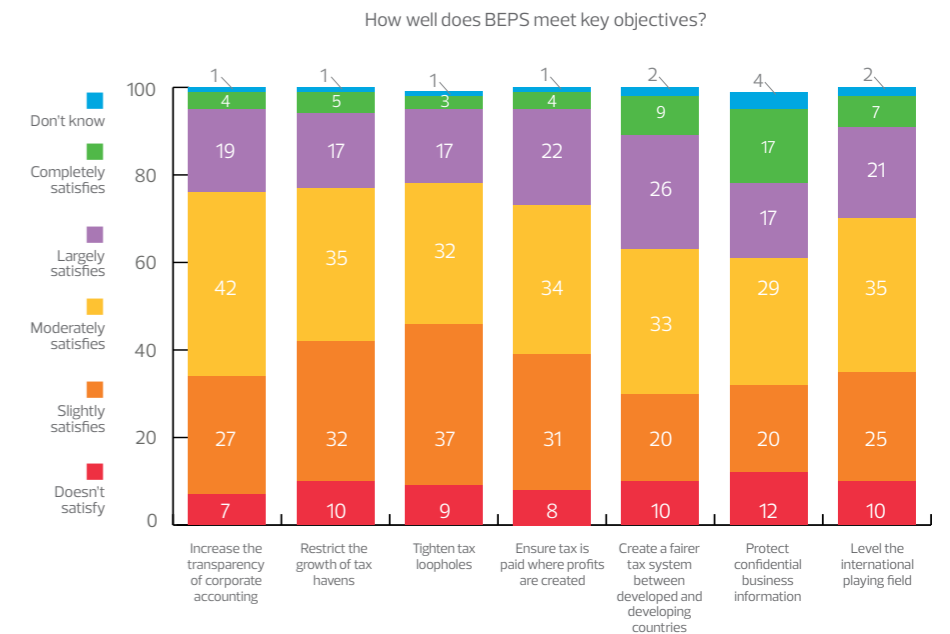
The BEPS Project has broad, albeit tepid, support.

“BEPS is creating significant uncertainty as it has created a lot of expectation of change, however the timing and manner in which those changes are being implemented by different countries varies widely. For instance, the UK has been a front runner in adopting the hybrid mismatch rules and these will take effect from 1 January 2017 but very other few countries will introduce rules by then. Therefore, whilst the BEPS initiative was intended to introduce consistent rules, the reality is very different.”

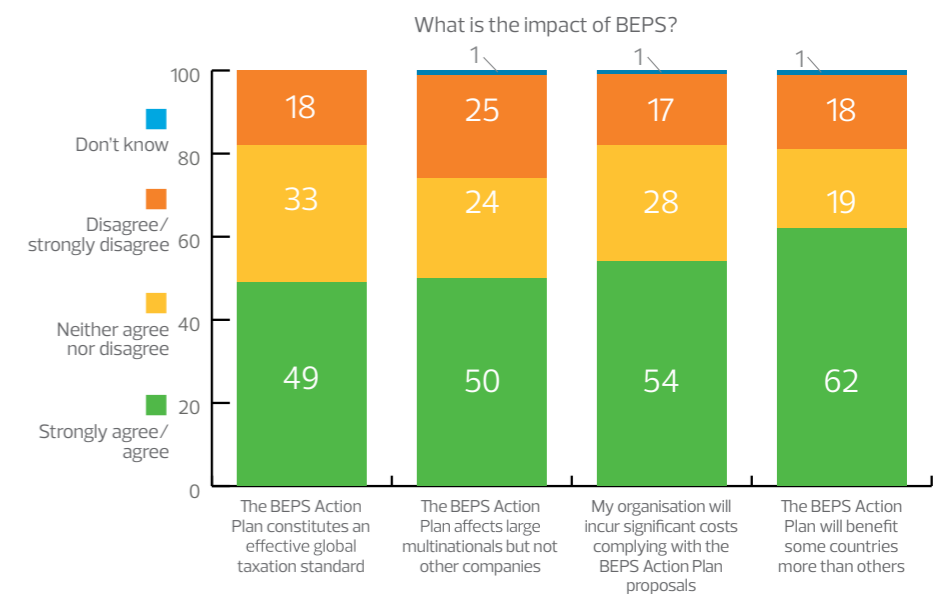
Head of Tax, Global Financial Services Organisation

The BEPS Project seeks to establish a more consistent, transparent and fair standard for global taxation that better ensures taxes are paid in the appropriate amounts and in the appropriate jurisdictions. Respondents to the survey support that goal, with 69 percent agreeing that some form of global taxation standard is necessary and 54 percent indicating that the BEPS initiative is the best solution.

Respondents were asked to assess how well the BEPS Action Plan satisfies seven specific objectives. As the chart below indicates, respondents were generally, but not overwhelmingly, satisfied that the BEPS Action Plan met these objectives. Respondents from smaller companies were more likely to believe that BEPS does not satisfy objectives than were respondents from middle market or large companies. Respondents were almost evenly split on the question of fairness, with 35 percent stating that BEPS largely or completely satisfies the objective of establishing a fairer tax system between developed and developing nations and 30 percent stating that it only slightly satisfies or does not satisfy that objective. Among respondents, 61 percent felt the BEPS Action Plan only moderately satisfied, slightly satisfied or did not at all satisfy the primary objective of ensuring tax is paid where profits are created, and only a third (35 percent) felt it would largely or completely satisfy the objective of leveling the international playing field.



Respondents were also asked the extent to which they agreed or disagreed with three statements about the impact of BEPS. Opinions varied. One finding of note: 62 percent of respondents believe that BEPS will benefit some countries more than others. The OECD's Action Plan was built on existing international tax principles of residence-based taxation. Critical opponents of the Action Plan believe that this favors developed countries. For example, as capital exporters, OECD countries like Japan have an interest in residence-based taxation, which enables them to tax a larger share of repatriated profits earned offshore. As capital importers, emerging countries benefit more from taxation based on source, which allows them to tax larger amounts of income within their borders.

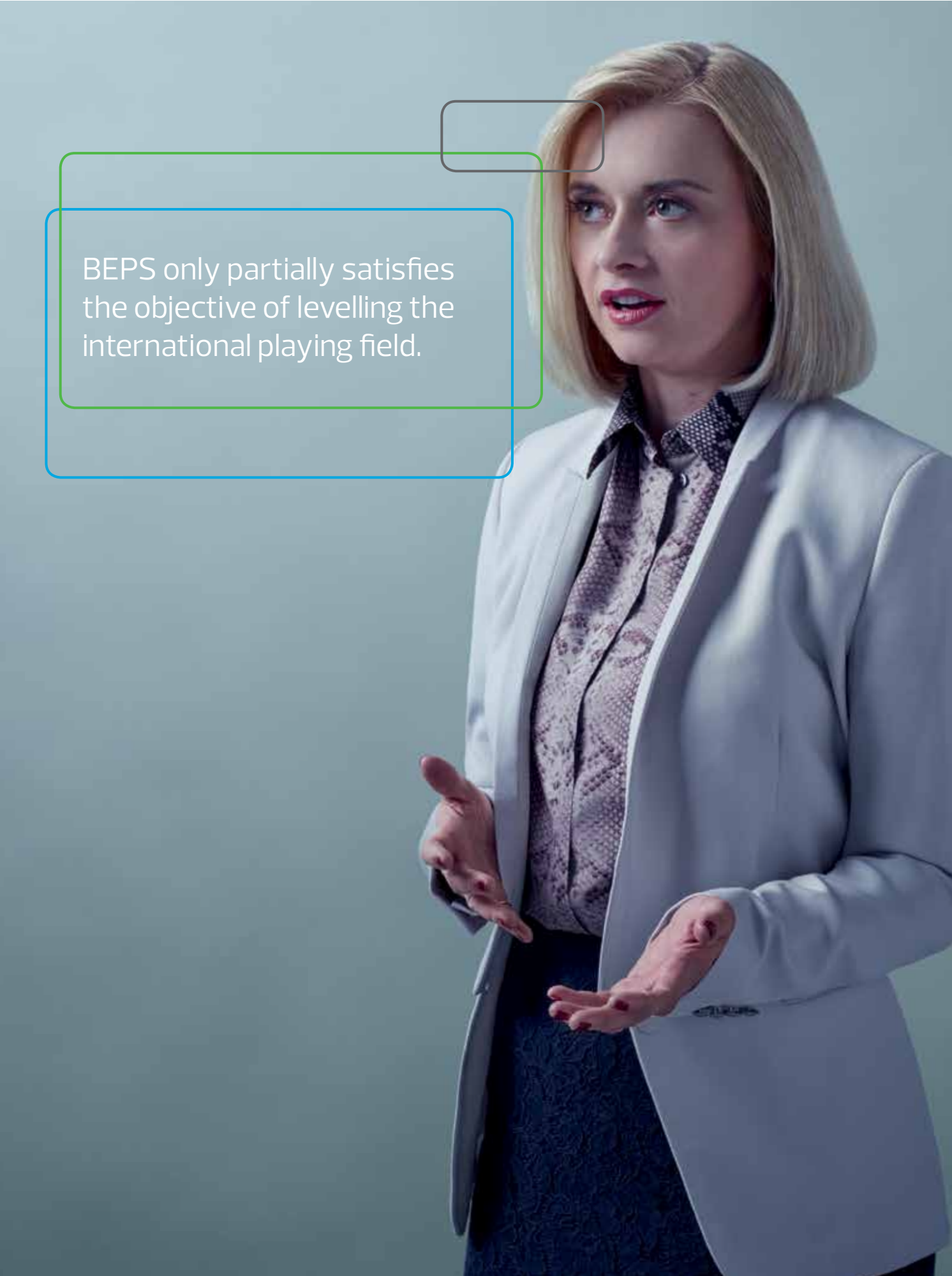


IS FAIRNESS OVERRATED?

Fairness was not a top concern when respondents were asked to select the principles they would like to see guide future tax rules and regulations. Surprisingly, neither was cost. Respondents ranked the principles in order of importance as follows:

1. Practicality with the business
2. Simplicity
3. Transparency
4. Fairness
5. Cost of implementation
6. Other principle

Responses indicate, perhaps not surprisingly, that businesses currently confronted with the complex and changing tax landscape due to the implementation of new tax laws resulting from the BEPS Project rank tangible and concrete matters such as practicality with the business and simplicity as the highest principles to guide future tax rules and regulations. It will be interesting to see, as the implementation of BEPS measures slows down, whether there is a shift to more abstract principles like fairness.



BEPS only partially satisfies the objective of levelling the international playing field.

BRACING FOR CHANGE

Understanding the present,
preparing for the future.

When the BEPS Project was first announced, the broad perception was that it would primarily target large, multinational organisations. However, the survey demonstrates that, as middle market companies have learned more about the BEPS Project, they have realised that they, too, will face significant changes. Not even small companies will be immune—and BEPS may affect them more than they anticipate.

The general direction of the BEPS Action Plan is clear, but with countries enacting legislation at a very uneven pace, companies will need to monitor results to see how they will be affected overall and in the specific jurisdictions in which they operate. However, the survey results make four things clear:

- Middle market companies expect that the BEPS Project will affect them to nearly the same extent that it will affect large companies.
- Compliance costs and global effective tax rates will increase, possibly significantly.
- The BEPS Project is creating considerable strategic uncertainty.
- Many current tax structures and strategies will no longer be effective as the BEPS Action Items go into effect; many respondents anticipate making changes to their corporate structures, with a significant percentage even planning a complete overhaul.

The BEPS Project is driving the most significant changes in international taxation in decades. Companies of all sizes need to understand and prepare for those changes.

WHAT SHOULD BUSINESSES DO TODAY TO PREPARE FOR IMPLEMENTATION OF THE BEPS ACTION ITEMS?

Four steps businesses
can take today.

BEPS is and will remain an evolving challenge. While some countries have moved aggressively to enact legislation to support the BEPS Action Plan, others have moved slowly or not at all. Still, there are steps companies can and should take today to prepare.

“All companies, regardless of whether they are small, middle market or large, need to be paying attention to the changing international tax landscape resulting from the BEPS Action Plan. In today's economy even small startups can quickly find themselves operating on the global stage and affected by changes around the world as countries move ahead with implementation of the BEPS measures.”

Grace Perez-Navarro, Deputy Director, Centre for Tax Policy and Administration, OECD. Paris, France.

Preparation and risk analysis are key in order to navigate country changes and new developments from the OECD as several outstanding substantive BEPS proposals are completed. It is imperative that companies look at their global operational and tax footprints to assess where BEPS is relevant and how the various BEPS action items affect operations. Companies should then develop a scorecard approach to assess priority items in combination with related local-country developments.

Engage in strategic planning in order to be flexible enough to adapt to specific BEPS-driven changes. Companies should coordinate tax planning, treasury functions and operations and then develop strategic plans that include BEPS priority items and the identification of key potential risk areas along with steps for changes to meet new requirements. They should also implement strategies to change existing non-compliant structures, protect the company's effective tax rate and maintain clear communication lines with company stakeholders, including executive teams, treasury and accounting.

Evaluate current systems in light of preparedness for compliance obligation changes. The increased transparency required under the BEPS proposals gives governments better insight into the total business dealings of internationally active companies and puts pressure on companies to report data accurately. Assessment of whether current systems are ready to handle increased levels of data and reporting is crucial.

Monitor new country changes in order to stay abreast of the latest thinking and amendments. Changes are happening fast, with no slowdown in sight. Companies will need to assign dedicated teams to keep track of developments on BEPS compliance issues and country-specific changes or engage advisors to work with them to stay up-to-date on the changes.



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