Kluwer International Tax Blog

Tax Risk Management in BEPS Times: A Trap for the Unwary?

Guillermo O. Teijeiro (Bomchil) · Monday, January 4th, 2016

A Latin American Perspective

Until very recently tax risk management concepts were quite stable. The over-riding principle in this area was and still is that tax risk is best managed by the prevention of all unnecessary disputes; but as simple as this principle appear to be, taken to an extreme, avoidance of all potential tax disputes would crystallize in an overly conservative perspective of business which somehow collides with the corporate objective of maximizing profits and, hence, enhancing shareholder value, so that from the very outset, tax risk management poses an almost insurmountable conceptual hurdle on Board members and key financial and tax managers.

Even assuming that conceptual collision, the longstanding and well-settled technical separation between legitimate tax planning, on one hand, and tax avoidance/evasion, on the other, has traditionally helped Boards and corporate managers to trace a definitely line between what is allowed and what is not in terms of corporate tax behavior.

That line, however, became weaker first in the political language and then in the tax authorities' perspective, particularly since the industrialized countries' dissatisfaction with revenue collection levels from MNEs deepened after the 2008-9 world financial crisis, thus making corporate managers' tax risk assessment (including the task of identifying inappropriate behavior) much more complex and challenging.

In that scenario the question easily flows: How to balance the maxim of avoiding unnecessary tax disputes with the goal of preserving shareholders' value in a tax world where everything appears to be reproachable but for a corporate tax behavior assuming the highest possible tax exposure under the circumstances?

Even in this defiant, agitated new scenario, somehow at variance with the predictability needed to appraise tax risks at the corporate level, it is true that the appetite for profits and even the goal of enhancing shareholders' after-tax returns are better served by preventing unnecessary disputes by a number of means, including

(i) the adoption strong technical positions, clearly explainable to the tax authorities whenever so required;

(ii) keeping track of facts documentation aligning economic substance with the legal forms chosen to execute business transactions; and

(iii) compliance procedures ensuring accurate and complete tax returns (including information returns for transfer pricing purposes).

Moreover, the assessment of tax risks at the corporate level must be made taking into account, particularly

(i) short as well as long-term considerations and consequences,

(ii) the impact on business reputation and/or brands, stock market pricing of shares, and the relationship with government, potentially affected by keeping an open and extended disagreement with the tax authorities,

(iii) the benefit of certainty vis-à-vis the maintenance of an uncertain (disputed) tax position.

Adopting solid tax positions to prevent undesired disputes in BEPS times would require to be particularly alerted on legislative and regulatory changes concerning substance, transparency, and other procedural requirements that may be adopted in any single market where the global company operates, as well as changes adopted under international conventional law (on a bilateral or multilateral basis).

Particularly troublesome areas for the global corporation to focus on in the LATAM region would be:

(i) the domestic matching rules among different jurisdictions recommended under Action 2 (Neutralizing the effects of Hybrid Mismatch Arrangements), an entirely new experiment in regional legislation except for a very few cases (e.g., Mexico);

(ii) the possible implementation of the new thin-cap criterion recommended under Action 4 (Limiting Base Erosion Involving Interest Deductions and other financial Payments), i.e., a limitation based on a given percentage of EBITDA that, if adopted, would replace the traditional debt-equity ratio limitation spread over LATAM;

(iii) the adoption of substance and transparency requirements under Action 5 (Countering Harmful tax Practices more effectively…), including a not yet implemented regional scheme of compulsory information exchanges concerning rulings on preferences, APAs and the like; as well as new requirements on transfer pricing documentation (master file, local file and CbC reporting) under Action 13;

(iv) the inclusion under the mandate of Action 6 of a new treaty-based PPT and/or LoB clauses in a regional treaty network where, traditionally, treaty shopping has been fought against through domestic GAARs (except for the case of Mexico);

(v) actions where the final reports' recommendations are more or less open to optionality [particularly Actions 1 (Addressing the Tax Challenges of the Digital Economy), 3 (Designing Effective Controlled Foreign Company Rules), and 7 (Preventing the Artificial Avoidance of Permanent Establishment Status)]; and, finally,

(vi) concerning Actions 8 to 10 on transfer pricing, new developments in the areas of intangibles, low-price inter-company services (including financial services), cost contribution agreements, and commodities exports. In this last area, it would be interesting to observe if prior over-aggressive

domestic legislation in the region is re-aligned with the more reasonable outcome of the OECD-G20 Final Report.

Besides, it should be bear in mind that aside from Mexico and Chile, there are no other OECD member states in LATAM, so that beyond previously undertaken political commitments from G20 countries like Argentina and Brazil, OECD would lack coercive means to align technical responses at national level in the region so that a certain risk exists that in implementing the Action's outcomes, domestic variances might create an un-level playing field depending on the company's residence and the source of income within LATAM.

Whether entrusted to ordinary tax managing corps or specially-created tax forces within the global corporation and throughout a chain of ownership, following up and cross-checking international and domestic new tax developments during the already launched BEPS' implementation stage would be a vital risk management tool aimed at mitigating potential damages, while, on the contrary, lack of an overall or regional preparation to face domestication of BEPS principles may be a source of an undesirable increase in future tax litigation.

Notwithstanding the foregoing, it is worth mentioning that even the most alerted global corporations should be aware of potential unavoidable inter-jurisdictional conflicts among countries, at least until they consent on a uniform allocation of the greater global tax basis coming from BEPS progresses against income erosion and shifting. At instances, inter-jurisdictional conflicts might generate cascade taxation affecting cross-border trade and investment of which the global company should be aware of to reduce or minimize damaging tax consequences.

Still, at instances, the global corporation operating in LATAM would be facing the adverse practical effects of an extremely narrow perception of the BEPS project's objectives; this is so because quite frequently the project is merely viewed as affording the tax administrations a new tool to fight tax evasion in the international scene. The BEPS brand is thus misused to articulate and justify under its umbrella over-aggressive, press-oriented audits or collection measures against MNEs, which at times end up in a tax nothing. They are often mere technical adjustments disguised under the garb of a tax scandal, without a significant revenue effect but with a huge reputational damage on the MNE concerned (the Procter & Gamble case that broke out in Argentina in October 2014 in a clear example of this practice).

Finally, tax risk assessment at the global corporation in BEPS times is to be necessarily associated with the Mandatory Disclosure Rules of Action 12, which call for the disclosure of aggressive or abusive tax planning schemes by taxpayers and promoters.

Until now, it appears not to exist an enthusiastic trend towards the incorporation in LATAM legislation of this type of rules. So far, only Mexico has incorporated them, and Brazil is currently struggling with a bill under Congressional consideration fiercely fought against on constitutional grounds. Future attempts to pass similar rules in other countries of the region, however, are possible.

The design of these rules should make them compatible with constitutional principles (e.g., they should not contradict guarantees against criminal self-incrimination). Moreover, as long as international (cross-border) bilateral or multilateral transactions are concerned, these rules should not apply until post-BEPS domestic legislation stabilizes so that risk-taking abusive tax planning transactions are best identified, and distinguished from defensive or self-protective taxpayer's

measures in a potentially chaotic interim period.

To make sure you do not miss out on regular updates from the Kluwer International Tax Blog, please subscribe here.

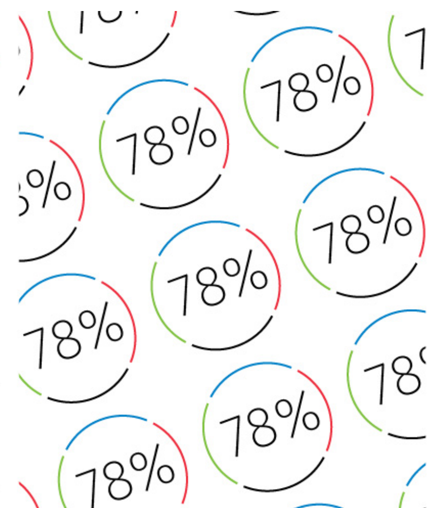
Kluwer International Tax Law

The **2022 Future Ready Lawyer survey** showed that 78% of lawyers think that the emphasis for 2023 needs to be on improved efficiency and productivity. Kluwer International Tax Law is an intuitive research platform for Tax Professionals leveraging Wolters Kluwer's top international content and practical tools to provide answers. You can easily access the tool from every preferred location. Are you, as a Tax professional, ready for the future?

Learn how **Kluwer International Tax Law** can support you.

78% of the lawyers think that the emphasis for 2023 needs to be on improved efficiency and productivity.

Discover Kluwer International Tax Law.
The intuitive research platform for Tax Professionals.



2022 SURVEY REPORT
The Wolters Kluwer Future Ready Lawyer
Leading change

This entry was posted on Monday, January 4th, 2016 at 3:11 pm and is filed under Tax Planning
You can follow any responses to this entry through the Comments (RSS) feed. You can skip to the end and leave a response. Pinging is currently not allowed.