

# Kluwer International Tax Blog

## **BEPS Transfer Pricing Implementation: consensus-based framework or unilateral measures which lead to global tax chaos marked by massive re-emergence of double taxation?**

Jonathan Schwarz (Temple Tax Chambers; King's College London) · Wednesday, March 23rd, 2016

The OECD BEPS project was kicked off by the observation that the interaction of domestic tax systems sometimes leads to an overlap, resulting in double taxation as well as gaps, which result in an item of income not being taxed anywhere, thus resulting in so called “double non-taxation”. Cooperation among countries historically addressed double taxation ([OECD \(2013\), Addressing Base Erosion and Profit Shifting](#)).

That observation resulted in the BEPS Action Plan [Action Plan on Base Erosion and Profit Shifting](#) (OECD 2013). The Action Plan observed that “the replacement of the current consensus-based framework by unilateral measures, could lead to global tax chaos marked by the massive re-emergence of double taxation.”

Already, as countries develop their responses, there are worrying signs that the worst fears of the OECD may well be justified. BEPS is a multifaceted project. Transfer pricing is perhaps the single largest aspect from a practical perspective. Transfer pricing aspects of the first Budgets following the BEPS Final Reports in October 2015 of the United Kingdom and Canada, two leading OECD members and two of the largest economies in the world suggest that there may be trouble ahead.

The OECD Final Report on Actions 8, 9 and 10: [Aligning Transfer Pricing Outcomes with Value Creation](#), is yet to be approved by the OECD Committee on Fiscal Affairs. Their approval is a precondition to the proposals set out in the BEPS final report becoming part of the OECD Transfer Pricing Guidelines. The Final Report itself states that the changes will be incorporated in those Guidelines.

### **United Kingdom Budget 2016**

A policy paper issued by Her Majesty's Revenue & Customs (HMRC) in conjunction with the UK 2016 Budget on 16 March 2016 states that legislation will be enacted to give effect to the BEPS final report on transfer pricing from 1 April 2016. This follows the Diverted Profits Tax, introduced in last year's budget and enacted in the Finance Act 2015 which contains its own super-transfer pricing rule (involvement in transactions lacking in economic substance). The Diverted Profits Tax is designed to operate outside tax treaties so that normal international dispute resolution mechanisms may not apply (See my blog: [Does UK Diverted Profits Tax hurt or help BEPS?](#) 11 February 2015).

## Canada: Federal Budget 2016

The Canadian Federal Budget delivered on 22 March 2016 includes a statement that the Canada Revenue Agency (CRA) is already applying the revised OECD guidance on transfer pricing. This, it is said “provides an improved interpretation of the arm’s length principle”. This application is selective in that the CRA will not be adjusting its administrative practices at this time to the proposed simplified approach to low value-adding services and to the treatment of so-called cash boxes. On these issues, the CRA wait for the OECD to complete its work.

The premature introduction of the final report proposals into UK law will put the UK transfer pricing regime out of sync with other OECD member states, and no doubt, emerging economies since the UN tax committee is yet to consider the issue. It will create a headache for UK based multinationals and foreign based companies investing in the UK who will need to have one set of rules for the UK, and one for the rest of the world until the two are brought into alignment.

It is telling that the HMRC policy paper observes that the revenue impact for the foreseeable future will be nil. Perhaps the reason for this is that, ultimately, after time-consuming and expensive mutual agreement procedures have resolved resulting double taxation, the UK Exchequer will be back to where it started.

Administrative practice of the CRA will have a similar effect, although taxpayers will still be in a position to argue (including before the courts) that this practice does not accord with the law or with the arm’s length principle, particularly in light of the ruling of the Supreme Court of Canada in *Canada v. GlaxoSmithKline Inc.*, [2012] 3 SCR 3, 2012 SCC 52 (CanLII).

## OECD constitutional requirements

The more fundamental issue is that tax administrations in both countries, who are leading members of the OECD, have both ignored the constitutional requirements of the OECD itself in order to bring the BEPS Actions 8-10 Final Report proposals into the OECD Guidelines, and have adopted unilateral approaches that are more likely to generate than solve conflicts in international taxation.

[OECD statistics](#) before the BEPS Final reports already show a continuous increase in recourse to Mutual Agreement Procedures to resolve double taxation. While BEPS Action 14 aims to improve these mechanisms, the real way to resolve conflict is to prevent it happening in the first place. Where the leadership for a genuine coordinated approach is to come, is yet to emerge.

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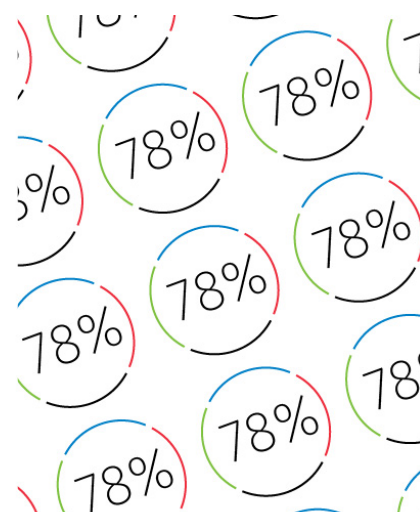
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