



euromoney institutional investor
thought leadership



TREADING THE PATH TO TRANSPARENCY

What businesses think of BEPS



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THE BUMPY ROAD FROM IDEALS TO PRACTICE

“Playtime is over,” said Pascal Saint-Amans, director of the OECD’s Centre for Tax Policy, a month after his organisation’s October 2015 release of the Final Reports of the Action Plan on Base Erosion and Profit Shifting (BEPS).

He was speaking about companies, but in many ways, he could have been addressing national tax authorities. The reports were no small achievement but are far from the final word in the process. Now, legislators and tax officials face the complex task of deciding what the BEPS measures will mean in practice, as they turn the Action Plan’s ambitions into the concrete reality of national regulation.

This process will be messy and uneven. The scope of changes involved and the deadlines in the reports mean that some matters will have a higher priority than others. Already, a large number of countries including China, Canada, and the United Kingdom have moved forward on regulations for the related issues of country-by-country reporting (Action 13) and transfer pricing (Actions 8 through 10). Other areas, such as mandatory disclosure and the definition of permanent establishments have, so far, received less attention.

Jurisdictions are also moving at different speeds in what remains a politically charged process. In January 2016, for example, the European Commission’s proposals to implement BEPS went beyond the Action Plan guidelines, leading to push-back from national governments. In February of this year Germany’s finance minister, Wolfgang Schäuble, strongly insisted that initial regulations should “implement what has been agreed in BEPS...and nothing else, otherwise it will

take a lot of time to take a decision.” Other countries face some difficulty in reaching even this circumscribed goal. After the United States Treasury published its country-by-country reporting proposals, the head of the House of Representatives’ main tax legislation writing body – the Ways and Means Committee – proposed legislation which would deny corporate information to any country thought not to respect the confidentiality of US companies’ data. Saint-Amans has publically acknowledged that it would be “naïve” not to recognise the ability of partisan politics to hinder the BEPS process.

Finally, certain ongoing weaknesses with the process itself have also become clear. The project has been criticised for having been excessively dominated by OECD and G20 countries. In February 2016, it was opened wider, giving many more of the world’s poorer countries a voice on remaining debates on standards and implementation monitoring. These governments are likely to push for further changes. Christine Lagarde, Managing Director of the International Monetary Fund, believes some of the needs of such states remain unaddressed by BEPS. Despite undeniable progress, in February 2016 she said “much more work needs to be done both in terms of substance and scope”.

BEPS, then, is an irreversible reality for companies and a work in progress for governments. As implementation crystallizes what the guidelines actually mean, the thinking of corporate leaders on the process and its likely outcomes is of particular interest. This Euromoney Institutional Investor report, sponsored by the global audit, tax and consulting network, RSM, summarises the results of a large global survey of senior executives about the implications of BEPS for tax standards, the business environment, and respondents’ own companies.

THE KEY FINDINGS ARE: THE COST OF BEPS

This will cost someone money – with taxes on the largest companies expected to rise 7% on average – but it is still not clear who will pay.

Just over half of those surveyed (54%) believe that “my organisation will incur significant costs complying with the BEPS Action Plan proposals,” while only 17% are confident that this is not the case. Digging deeper, though, shows respondents varying definition of the word “significant” obscures the number of companies which will be paying more.

Overall, 92% of those surveyed expect to see some increase in compliance costs as a result of BEPS implementation and these rises will not be slight: 68% say that they will be paying over 10% more than they had previously for compliance in the post-BEPS world. The median predicted rise is 17%.

Respondents also expect to see taxes rise as a result of BEPS, but at lower levels than compliance costs. Seventy-two percent foresee some increase in tax liability, with 51% saying that this will be over 5% of the current bill. Here, the median increase is 5%. There is, though, a marked variation based on company size. Just under half (49%) of respondents from firms with annual revenues under \$50m project no increase, with the median predicted rise for this group also rounding to 0%. Those from businesses making between \$50m and \$5bn expect a median increase of 5%. For the largest firms it rises slightly to 7%.

Whatever the final sum, costs are going up and will not be trivial, especially for the biggest companies. This seems appropriate and predictable, as BEPS was in large part a political response to popular outrage over the seeming ability of multi-national companies to avoid paying taxes in some countries. It is not, however, the whole picture.

Opinion is split on who will ultimately have to pay for these bills when they come due. Fifty-four percent believe that it is “likely” or “highly likely” that organisations will have to take on some of the costs arising from BEPS implementation, and 34% think customers will probably be passed part of the bill. A further 21% are not sure if customers will be made to pay anything extra or not.

Inevitably with any new regulation, who ultimately pays the attendant costs often depends on economic factors such as the ability of customers to choose between a large number of competitors to keep prices down. In the case of BEPS, for example, 62% of manufacturers think it is likely that the organisation will have to swallow some of the resultant costs but in consumer products only 50% do. However, beyond these details the broader message is clear. If BEPS is successful in making companies pay a notionally fairer share of tax, it is unlikely that they will foot the bill all by themselves.

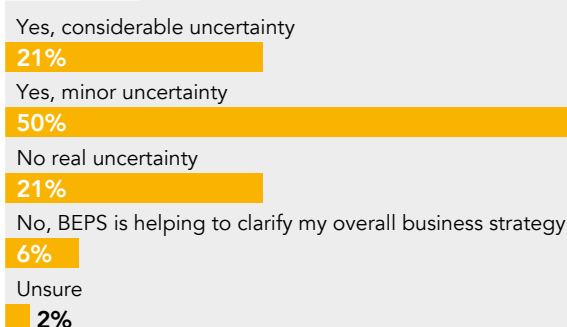
EARLY STAGE IMPLEMENTATION

While expected to affect a majority of companies, most executives foresee only limited difficulties, and often even positive outcomes, to arise from the early stages of BEPS implementation.

Given the nature of BEPS implementation, it is no surprise that a majority of respondents (71%) say that it has created at least some uncertainty for their business strategy (see chart 1). The full extent of the uncertainty though, may be less than one might have anticipated in the face of potentially large regulatory change.

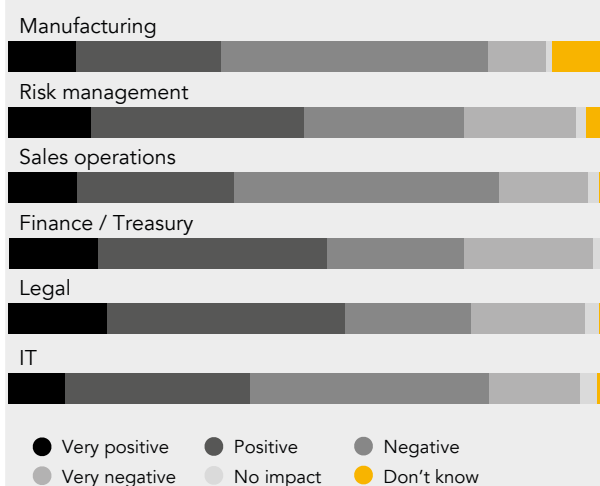
Nor do those surveyed expect such effort to be without benefit for their companies. Far more expect BEPS-related changes to have a positive rather than a negative effect on every corporate function covered in the survey. This includes not only compliance related areas, including legal and risk management, but also areas such as manufacturing and sales (see chart 2). Again, for most companies the foreseen degree of change is not extensive – most respondents predict only some positive change or none at all rather than a large shift in either direction – but also noticeable and widespread among those surveyed.

Chart 1. Is the BEPS Action Plan creating uncertainty with your overall business strategy?



Source: Euromoney Institutional Investor Thought Leadership

Chart 2. What impact do you think the BEPS Action Plan will have on the below functions within your organisation?



Source: Euromoney Institutional Investor Thought Leadership

CHALLENGES OF BEPS

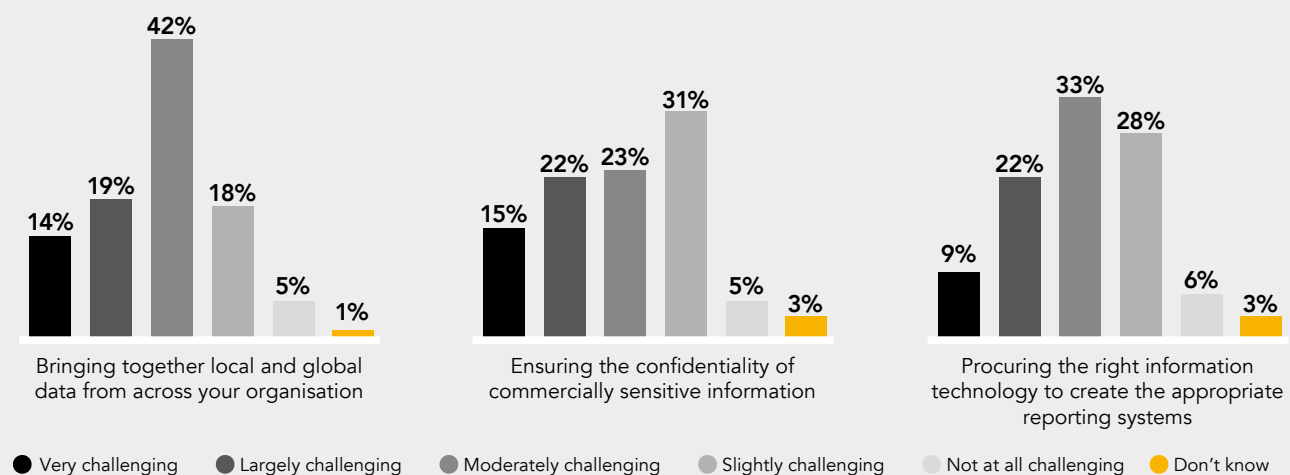
**More a chore than a nightmare:
A majority of businesses need to
address diverse impacts of BEPS
implementation, but on average
respondents think these challenges
are moderate.**

Our survey reveals that, in three key areas, most companies are not waiting for national governments to finalise BEPS-related regulations before they get ready for the new dispensation.

Country-by-country reporting and transfer pricing:

The speed with which countries are rolling out regulations around BEPS Actions 13 and 8-10 makes these areas understandable priorities. A large majority of businesses are reacting: 70% of respondents report that their firms are either planning or implementing changes to align with BEPS transfer pricing rules. A further 22% say that they are already fully aligned with this aspect of BEPS. In at least some of these cases this may indicate that they have completed the necessary changes, although in others it will mean that no changes were required. The survey did not ask about the difficulty of such alignment in general, but did look specifically at key aspects of complying with new country-by-country reporting requirements under BEPS Action 13. As chart 3 shows, while between a quarter and a third of firms find each aspects very or largely challenging, well over half say each is only moderately or slightly so.

Chart 3. How challenging are the following in preparing for country-by country reporting?

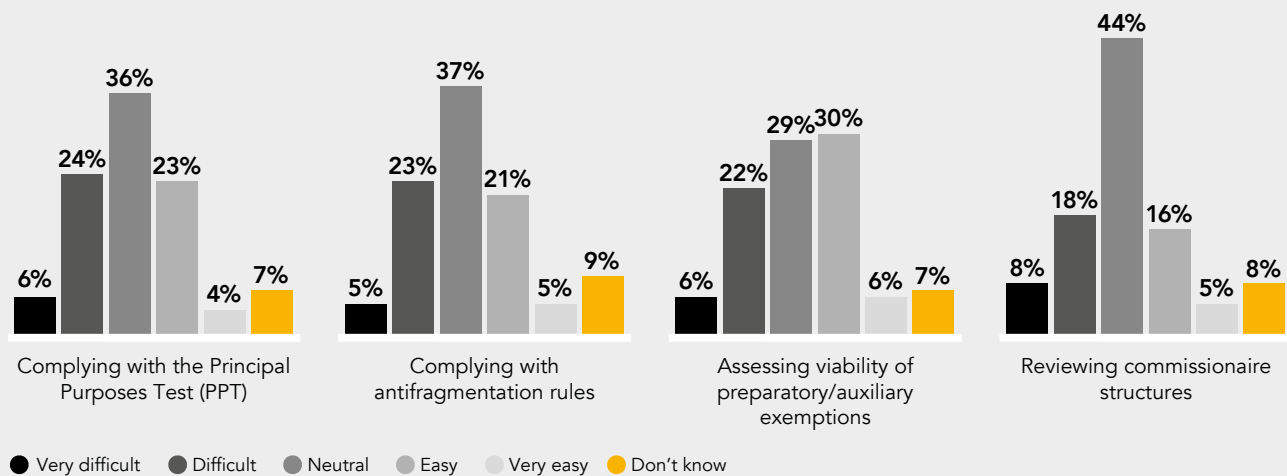


Source: Euromoney Institutional Investor Thought Leadership

Permanent establishments:

Although fewer governments have moved ahead on this action point than on country-by-country reporting, survey respondents' companies have been preparing almost as actively here. Sixty-nine per cent are either planning or implementing changes to bring themselves in line with the BEPS definition of permanent establishment and a further 21% are already aligned. Again, respondents are roughly evenly split on whether the key steps in this process are difficult or easy, with the overall opinion that they are somewhere in between.

Chart 4. How difficult are these aspects of Permanent Establishment definition under BEPS?



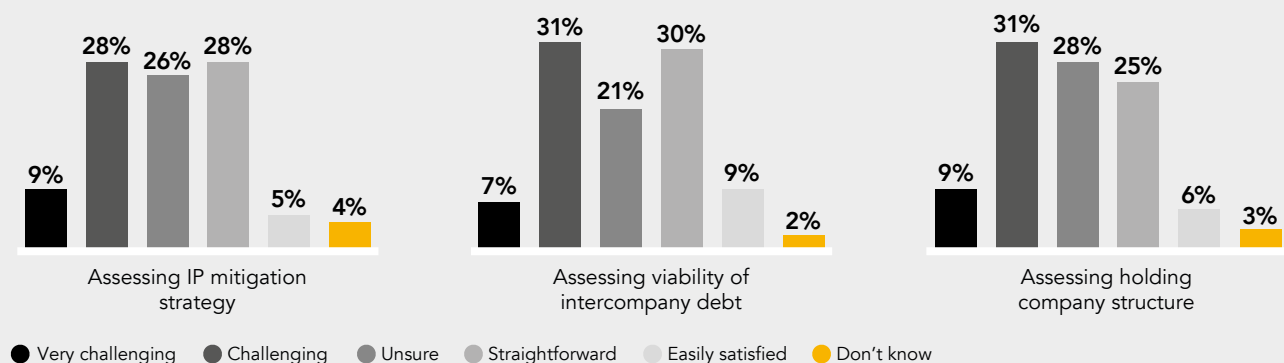
Source: Euromoney Institutional Investor Thought Leadership

Changing Group Structures:

A large majority (73%) report that BEPS will make changes to their group structure necessary, with nearly 41% thinking that these changes will be significant or even necessitate a complete overhaul.

As with other action points, respondents are roughly split between those who see the specific steps as challenging or straightforward and few expecting it to be very hard or very easy.

Chart 5. How challenging are the following elements of restructuring in compliance with the BEPS?



Source: Euromoney Institutional Investor Thought Leadership

BEPS AND COMPANY SIZE

The conventional wisdom on company size is wrong: although the focus of BEPS discussion is often on large companies, the compliance burden for medium-sized firms will be similar.

Out of all of the respondents, 50% say that “The BEPS Action Plan affects large multi-nationals but not other companies.” Only 25% disagree. A closer look at how companies are responding to BEPS implementation, however, paints a very different picture.

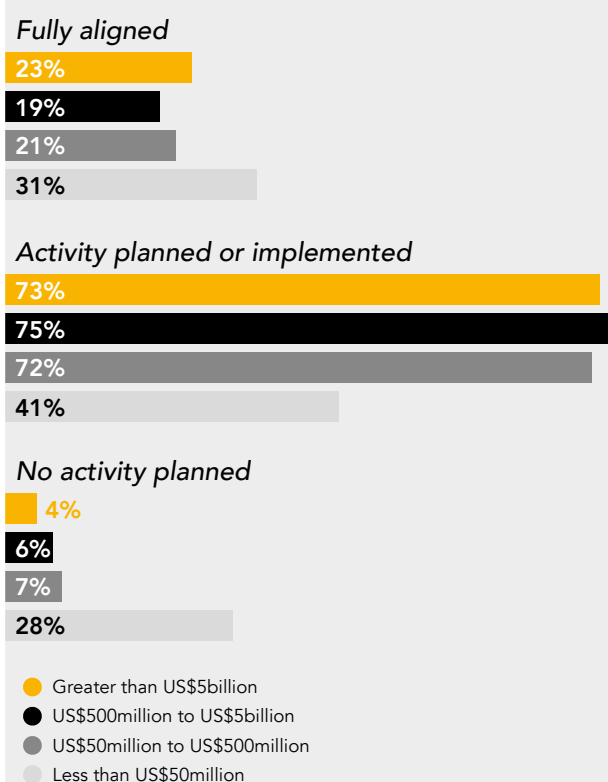
As the charts show, the smallest companies – those with annual incomes under \$50m – are noticeably less affected than other businesses. However, those with medium levels of revenue and the biggest firms are seeing remarkably similar levels of activity around alignment with rules on transfer pricing and permanent establishments.

Although less pronounced, there are also similarities in the extent to which larger and medium sized companies will need to restructure. Predictably, somewhat larger numbers of the biggest firms will require significant restructuring, but the need for change is still widespread for all of those earning above \$50m annually.

The most telling similarity among all companies relates to compliance costs. Although those with annual revenues of between \$50m and \$500m are slightly lower, the bigger story is the close similarity across all sizes of company.

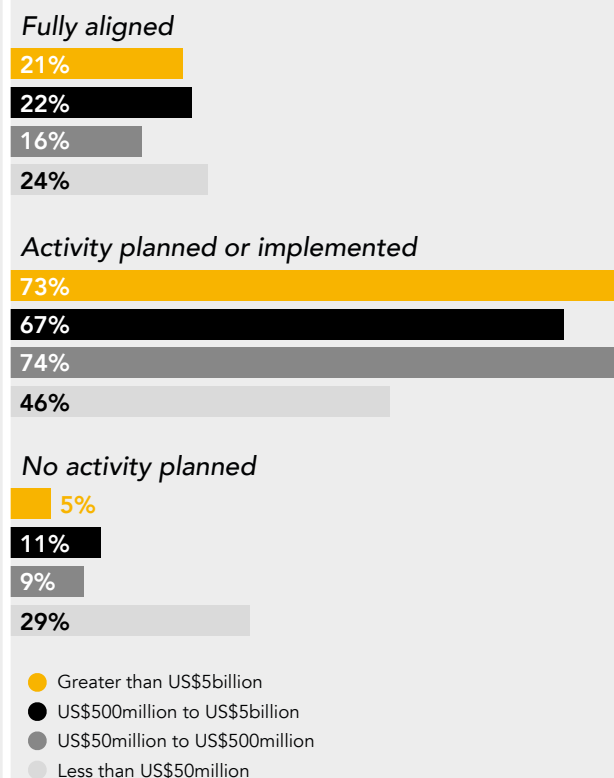
As noted earlier, medium sized firms expect that they will see only slightly smaller BEPS-related tax increases. Relative to size, they will also need to do just as much additional compliance work as bigger companies to keep the tax authorities satisfied.

Chart 6. To what extent is your organisation conducting activity to align with the BEPS Transfer Pricing rules?



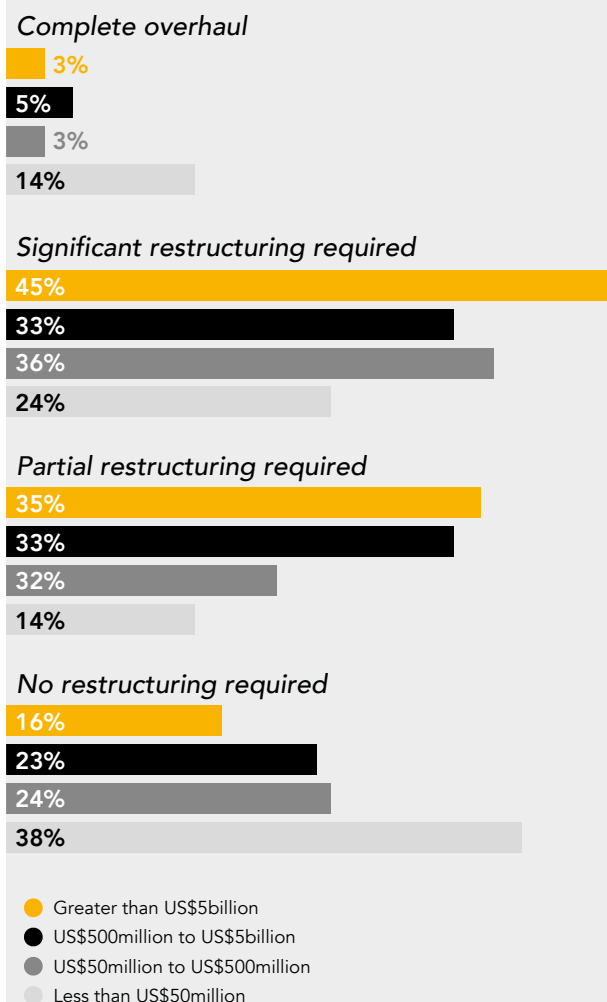
Source: Euromoney Institutional Investor Thought Leadership

Chart 7. To what extent is your organisation conducting activity to align with the BEPS PE definition?



Source: Euromoney Institutional Investor Thought Leadership

Chart 8. To what extent does your organisations' group structure have to change in order to comply with the rules of the BEPS action plan?



Source: Euromoney Institutional Investor Thought Leadership

Chart 9. Median percentage increase in compliance costs due to BEPS by company revenue



Source: Euromoney Institutional Investor Thought Leadership

TOWARDS A GLOBAL TAX STANDARD

What difference will the extra work and cost make? Business leaders think BEPS represents progress toward the benefits of a global tax standard but is in no way a complete solution.

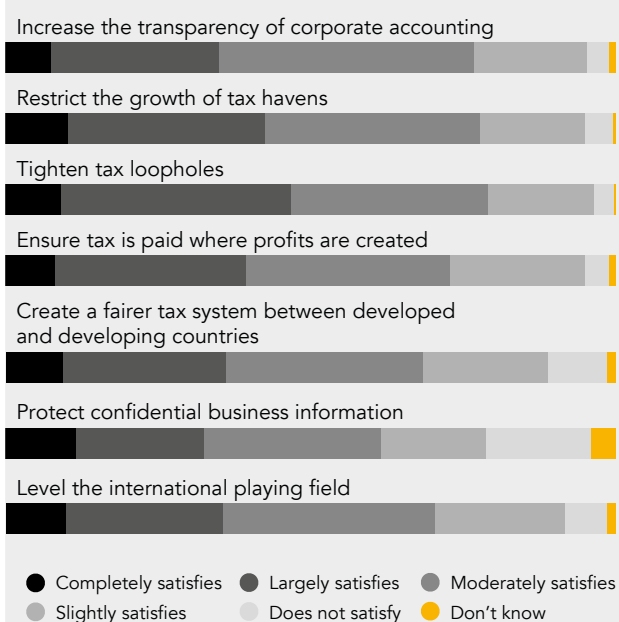
Survey respondents are largely convinced of the benefits of a global tax standard: 69% agree one is necessary. Moreover, most of this group (54% of the total) see BEPS as the best way to meet this need. This is not an overwhelming vote of confidence but still markedly higher than the number of those preferring another global standard or seeing no need for one at all (33%).

This positive – albeit reserved – reaction also comes through in executives' thinking about the likely effectiveness of BEPS in reaching its main goals. Few think it has been completely successful, but as the chart shows, most believe that it makes moderate or large progress toward satisfying its key objectives.

On the other hand, respondents believe that important weaknesses remain. Sixty-one per cent say that BEPS has been only partially, slightly, or not at all successful in addressing the tax challenges posed by the digital economy. Similarly, 53% believe that it does not deal sufficiently with the taxing of data goods and services compared with just 20% who disagree.

Overall, while conscious of the flaws of the BEPS Project, executives seem well-disposed, or at least open-minded, to the benefits it could deliver.

Chart 10. How much does the BEPS Action Plan satisfy these objectives?



Source: Euromoney Institutional Investor Thought Leadership



CONCLUSION

The drive toward what eventually became the BEPS process may have begun with public reaction to the perceived unfairness of how certain global companies addressed tax issues. The impact, though, will be far more wide ranging. For a large variety of issues – transfer pricing, group structure, where they do or do not have permanent establishments – lots of companies now recognise the need to take at least some action.

The challenge need not be overwhelming. The extent of the required response to BEPS varies widely by company. In many cases the difficulty involved will be only moderate.

Nevertheless, the compliance and potential tax costs that companies will inevitably need to pay, not to mention the possible regulatory and reputational risk of getting it wrong, mean that every company will need to consider carefully how it responds as the new, BEPS-driven regulatory dispensation comes into existence. In particular, although not the original focus of the process, middle-market firms will need to tread as carefully as bigger ones to avoid falling foul of the game's new rules.



ABOUT THE REPORT

In early 2016, Euromoney Institutional Investor Thought Leadership, in conjunction with global audit, tax and consulting network, RSM, conducted a survey of 494 senior executives worldwide. The respondent pool contained 46% based in Europe, 41% in North America, and 7% in Asia, and 7% in other parts of the world. Respondents came from a large variety of industries, with financial services (26%), professional services (24%) and consumer products (17%) the most represented. Those surveyed also worked for firms with a wide range of sizes, including 11% with annual revenues of less than \$50m, 42% with revenues of \$50m to \$1bn, and 47% with over \$1bn. Tax executives made up nearly a third (30%) of respondents, and those from the finance function just over a fifth (21%).

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