From the Editor:

OECD BEPS Action Plan Contains Few Surprises

By Jeremy Scott — jscott@tax.org

The OECD continues to push forward on its base erosion and profit-shifting initiative. The organization recently put together its action plan for BEPS, which will be released around July 15. The OECD's motives for becoming suddenly interested in protecting the tax base and preventing profit shifting can certainly be questioned by cynics, but the reality is that multinationals are likely to face a very different tax enforcement environment in the near future as a result of the BEPS report and the actions of revenue agencies in the developing world.

The BEPS action plan may not have been released to the public, but Lee Sheppard reports that the plan restricts the initiative to base erosion income tax issues (p. 22). The OECD group will confine BEPS to situations in which a multinational strips income out of a market country and into a low-tax jurisdiction, she says. The BEPS action plan also makes it clear that permanent establishment is on the table in a much greater way than the initial report indicated, she writes. The dependent agent/commissionnaire issue will be explored, along with the preparatory and auxiliary exception. Sheppard also reports that the BEPS action plan will address interest allocation (provided that countries can agree to an allocation), the digital economy, intangibles, and tax competition.

The dependent agent and commissionnaire question was the subject of a recent conference in Vienna. Sheppard writes that dependent agents are a sore spot in Europe, so it is possible that the BEPS initiative will result in an expansion of the tortured, narrow reading favored by multinationals (p. 7). Speakers at the conference criticized the OECD model treaty's article 5, which appears to have been badly translated, Sheppard says. The group explored the commissionnaire issue in detail, including how common law and civil law can affect how an agent's power is interpreted. British government speakers were clear that the United Kingdom intends to tax profits attributable to intangibles to the dependent agent PE. Sheppard calls this a brave new world and concludes that the era of resident country prerogative is over. Market countries are now determined to tax the residual profit being allocated to U.S.-developed intangibles, she says.

The OECD's actions matter, but maybe not as much as five or 10 years ago. The reality is that the new emphasis on protecting the tax base is being driven less by the United States and United Kingdom (the traditional powers behind the OECD) and more by disaffected developing countries such as Brazil and India. The rest of the world wants to protect its tax base — countries need tax revenues in this age of austerity. Even the rest of Western Europe is starting to chafe under OECD rules that allow so much profit to be shifted from high-tax jurisdictions where sales and development occur into low-tax countries that supposedly house subsidiaries that fund that research. As Sheppard says, the era of unlimited profit shifting seems to be coming to a close. Let's just hope that the OECD plays a productive role in forcing multinationals to pay a fair share of tax, rather than its usual role of justifying base erosion because of trumped-up concerns over double taxation.

DOMA

Last week the Supreme Court issued a landmark decision invalidating section 3 of the Defense of Marriage Act (p. 16). The Court's holding means that the federal government can no longer deny recognition to same-sex couples who are legally married. The 5-4 opinion was written by Justice Kennedy, who stated that the provision in DOMA violated the Fifth Amendment. The four justices who dissented focused on standing issues and the government's right to define marriage. Justice Alito, a dissenter, also wrote that same-sex marriage is not a protected right under the Constitution or a right with roots in the nation's traditions. The DOMA decision has numerous tax implications, as more than 200 code sections reference the definition of marriage, spouse, or related party. The IRS will undoubtedly face challenges implementing the ruling, especially because many unanswered questions remain about same-sex couples who were legally married in a state that recognized their union, but now reside in one of the 37 states that prohibit same-sex marriage. It is very likely that the Court will have to consider section 2 of DOMA (which allows states to withhold recognition to same-sex marriages) soon.

The Court's decision won't have much of an impact on the nation's fiscal picture, according to

Diana Furchtgott-Roth (p. 75). The CBO last estimated the effects of same-sex marriage in 2004, and found that recognizing it would reduce the deficit by up to $700 million. That isn't much considering total federal expenditures, Furchtgott-Roth says. The revenue and fiscal effects are small because of the low incidence of same-sex marriages, she concludes.

Commentary

A recent Tax Court case highlighted the intersection of professional golfing and royalty taxation. The case involved PGA pro Sergio Garcia, a nonresident alien, and what portion of his endorsement income could be classified as royalties instead of income for services. Although the Tax Court increased Garcia's tax liability, the case dealt a major blow to the IRS's overaggressive litigating position, according to Seth Entin (p. 59). The IRS has long misinterpreted the ''Artistes and Sportsmen'' article of U.S. tax treaties, he writes. He reviews the case and the relevant treaties and looks at how the IRS's position is fundamentally untenable, even if the court's decision is read narrowly.

The IRS's finalization of the so-called repair regs affects a bewildering number of industries — traditional manufacturers, mining companies, the oil and gas industry, and many service industries, among others. The regulations have introduced the new concept of plant property, which is used to determine which items can be immediately deducted and which have to be capitalized and recovered through depreciation. James Atkinson explores the concept of plant property and offers helpful suggestions for applying what will remain a factual standard with few bright lines (p. 69). Properly identifying units of property is the first step in applying the regulations, he writes. But it is only a first step, and companies need to be prepared to apply the same capitalization standards that apply to all other units of tangible property when determining deductibility, he concludes.

A cut or bruise is the classic example of physical injuries that are sufficient to trigger the section 104 exemption. The presence of a cut or bruise can also be an important threshold to excluding damages for emotional distress, writes Robert Wood (p. 79). He looks at a recent ruling that may place a reduced emphasis on the exact degree of physical harm suffered. The ruling involved a mass catastrophe that led to many injured parties. The IRS concluded that all of the damages resulting from the mass tort were excludable, including emotional distress, because of the presence of physical harm. While the ruling reached the correct, and obvious, conclusion, Wood argues that it is more significant after a second look. The IRS seems to be limiting the number of occasions in which damages need to be divided between physical and emotional portions when determining excludability, he concludes, adding that that has made section 104 administration much better.

In Of Corporate Interest, Robert Willens analyzes a transaction involving a taxpayer's attempt to transfer intangible property to a foreign affiliate in a manner that avoided the need to report deemed royalty income (p. 83). The IRS rejected the transaction, primarily on the basis of its understanding of the policy objectives of section 367(d), which required the reporting of that royalty income.

In 2011, 46.6 million taxpayers claimed the state and local tax deduction, deducting nearly $470 billion from their tax returns. Tax Facts by Yuri Shadunsky (p. 87) breaks down the deduction by state and looks at the average amount claimed per claimant. Californians led the way, claiming more than $81.1 billion in deductions. ■