Base Erosion and Profit Shifting: The OECD’s Action Plan
Prospects and Alternatives

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International Tax Reform Initiatives

● G7/8 - G20
  Harmful Tax Competition – 1998 OECD Report
derailed by Pres. Bush 2001 >> Exchange of Information
OECD standard: On Request, via bilateral TIEAs/DTTs
G8 Lough Erne Declaration 2013 : automatic & multilateral
TNC tax avoidance: Base Erosion & Profit Shifting
BEPS project launched July 2012
Interim report February, Action Plan August, G20 September 2013

● BEPS Action Plan
  15 Actions: proposals by December 2015
  Repairs to Rules: 9 Actions
    Coherence - 4
    Restoring International Standards - 2
    Transfer Pricing - 3
  Digital Economy: Study (12 months?)
  Data Collection
  Disclosure of Tax Planning
  Transfer Pricing Documentation
  Stronger Mutual Agreement Procedure (Arbitration)
  Multilateral Convention (package deal?)
Establishing International Coherence

- **Hybrid Mismatches**
  models for national measures
treaty provisions: tie-breaker rules?

- **Controlled Foreign Corporations (CFCs)**
  national measures? Ineffective, many attenuated (UK)
collective CFC regime?
target `unacceptable’ preferential regimes?
who decides what is acceptable?

- **Harmful Tax Practices**
  preferential regimes – target of CFC rules (unspoken)
Forum: peer-review process

- **Limitation of Deductions**
  interest, royalties, other payments reduce source country tax base
important for developing countries
used by some, e.g. Latin America (royalties)
investment disincentive?
may need coordination
easier if done collectively
Restoring International Standards

- **Treaty Abuse**
  
  Treaties to prevent double taxation and fiscal evasion
  
  National anti-abuse rules often ineffective (e.g. India)
  
  Treaty anti-abuse rule
  
  general?
  
  Targeted?

- **Artificial Avoidance of PE Status**

  no rethink of PE definition: Source-Residence split not a BEPS issue
  
  may reconsider attribution rules?
  
  `authorised OECD approach’ since 2008/2010
  
  rejected by some OECD countries, most developing countries
  
  is physical definition of PE suitable for digital economy?
  
  split between sales & delivery/ customer support artificial?
Transfer Pricing

- **Outcomes in line with `Value Creation’**
  need to recognise innovation is organic & cumulative not discrete
  interaction of all employees: research, development, production, marketing
  now also contributions from customers & users

- **Intangibles**
  Ch. 6 under revision since 2010, latest Draft August 2013
  starts from legal owner of specific intangible, transaction analysis
  adjustment based on Functions – Assets – Risks
  `control’ of R&D
  location factors: market features, location savings, workforce, firm synergies
  use of corporate names

- **Finance**

- **Other `high-risk’**
  e.g. joint expenditures, fragmented value-chains
Which Method?

- **Intangibles Draft**
  Any of the 5 approved methods, plus `others’? But
  resale & TNMM `one-sided’ so inappropriate, `reliable comparables in many cases... difficult or impossible’

- **Profit-Split**
  unsystematic >> arbitrary split based on haggling
  what level of aggregation of profits?
  consolidated accounts: but financial accounts unsuitable

- **Documentation**
  August 2013 White Paper
  2-tier: Global Master File & Local Supplements
  sensible, but needs stronger specification
  Combined and Country-by-Country Report

- **MAP & Arbitration?**
  Dangerous if no agreement on clear & workable rules
  should be transparent: reasoned decisions, published
An Alternative: Treating TNCs as Unitary

- **History**
  Alternative identified in Carroll report 1932 (Spain etc.)
  political obstacles (League)
  permitted for PEs; profit-split = ad hoc apportionment
  Used in federal states, e.g. USA, Canada, Switzerland

- **Federal States**
  USA: e.g. California: film distribution via Nevada
  optional till 1942; TNC campaign 1970s; `water’s edge’ election 1986
  harmonised (partly) since 1957, some variations in formulae
  Others: Argentina, Canada, Switzerland

- **EU Single Market proposal 2011**
  Common Consolidated Corporate Tax Base (2011)
  limited to participating states
  usual anti-avoidance rules (TP, CFC) with 3rd states
  but could deal with e.g. Luxembourg, Ireland (if they accept)
  better if integrated into global approach against international avoidance

- **Gradual Transition is Possible**
Elements of Unitary Taxation

1 Combined and Country-by-Country Report
   Group Consolidated Accounts
       already recommended by OECD & UN IAS, but OECD could develop template for tax base definitions
   Data on physical assets, employees, sales & taxes paid in each country

2. Profit Apportionment
   build on profit-split method `allocation keys’
       not attribution of where income `earned’
       assumes profit earned by firm as a whole
       allocation based on physical presence in country
   Physical assets (not intangibles)
   Employees/Payroll (could be 50:50 as in CCCTB)
   Sales by location of customers
       balance of production/consumption factors

3. Procedures for Agreement
   Advance Price Agreements (APAs): e.g. Starbucks, Google?
   Conflict resolution: based on MAP
Issues with a Unitary Approach

Tax Base Definition
- could start with financial accounting, develop tax definitions (use CCCTB)

Apportionment Formula
- states must balance attracting investment & generating tax revenues
  - without agreement likely to shift to sales basis
  - better to balance production/consumption, 3-factor formula
  - 2-step split: (i) operating expenses x normal profit rate (ii) residual by sales

Effect on Revenues
- states fix their own tax rates
- closing ‘tax gap’ & inequities could allow lower rates

Tax Jurisdiction
- based on business presence, to include e.g. website sales to retail customer
  - wider than PE definition which is too physical for digital economy

Effects on Investment
- tax on factors? - only to extent tax rates differ
  - firms could relocate? - yes, but real activities
  - intangibles? - firm’s know-how result of synergy, can’t attribute value to parts
    - e.g. basic research + development + marketing in Pharma
Transition to Unitary

- **Studies**
  OECD Base Erosion & Profit-Shifting project?
  UN Committee: needs resources
  needs serious research: ICTD; IMF

- **Regional Adoption**
  US States experience
  EU CCCTB: enhanced cooperation, euro `fiscal pact’?
  EAC?
  but should require worldwide Combined Report

- **Adopt Combined Reporting Immediately**
  UN Manual advises consolidated P&L and sales proportion data
  use to guide profit split
  apply to relevant sectors, e.g. global financial trading

- **Build on Profit-Split Method**
  apply suitable `allocation keys’
  or 2-stage: functional allocation + split of `residual’ profit
Pros & Cons

- **For TNCs**
  - risk of inconsistent rules & conflicting formulae?
  - global offset of losses against profits
  - much lower compliance costs

- **For States**
  - offset of foreign losses against local profits
  - much lower enforcement costs
  - reinforces fiscal sovereignty
  - higher revenues could allow lower marginal rates

- **Globally**
  - **comprehensive** solution to all TNC profit-shifting
  - remove respectability from tax havens
  - end temptation to offer tax incentives for FDI
  - redirect resources wasted on avoidance-enforcement
  - remove distortions on allocation of capital investment

- **Losers**
  - tax avoidance industry
  - tax havens
Comparison with OECD Approach

- **Political Feasibility**
  OECD: long & difficult road (3-5 years?)
  would generate conflict (e.g. CFCs vs HTPs)
  is package deal possible?
  Unitary: confront issue more directly
  work towards comprehensive solution

- **Effectiveness**
  holistic treatment of TNC essential

- **Developing Countries**
  need administrable system

- **Prediction**
  system will evolve towards Unitary
Asante Sana
Thank You
Dank U
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Obrigado
Vielen Dank