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# The G20 / OECD Base Erosion and Profit Shifting Action Plan

*by Pierre Habbard*

During a meeting held in November 2013 in St Petersburg, the G20 endorsed an Action Plan on Base Erosion and Profit Shifting (BEPS[1]) prepared by the Organisation for Economic Co-operation and Development OECD – the leading forum on international taxation. In line with addressing corporate tax "avoidance" practices, the 15 action points were to be delivered by end-2015.

The international cooperation on tax evasion has been on the G20 agenda since 2009 but tax avoidance is a fairly new topic for the G20. Unlike tax evasion – which is illegal – tax avoidance is in the grey area of compliance. It involves aggressive corporate tax planning schemes by Multinational Enterprises (MNEs) and financial institutions that exploit differences between jurisdictions to shift profits away from economically relevant jurisdictions ("Profit shifting") or to artificially reduce the taxable corporate income base ("Base erosion"). It is more difficult to detect and to deter but it leads to similar outcomes than tax evasion in terms of losses of revenues for governments.

For years, the OECD has not taken tax avoidance to heart but was rather more concerned about the risk of "double taxation" of MNEs operating over several jurisdictions. Prior to the 2009 crisis, OECD staff would in fact never miss an opportunity to praise "tax competition" between jurisdictions and the competitiveness of low-tax economies. But the political mood within OECD finance ministries changed post-crisis and, with that, the realisation that national tax laws have not kept pace with the globalization of businesses. In turn, this leaves gaps that can be exploited by MNEs to artificially reduce their taxes.

## The BEPS deliverables

On the 16th of September 2014, the OECD released a batch of reports[2] on the BEPS Action Plan as it is reaching mid-term implementation – a good opportunity for a stock taking on the key deliverables to be expected end-2015:

- Illicit transfer pricing: the most extreme forms of intra-MNE transfer pricing manipulation should be dealt with under the BEPS. An example hereof is the "Double Irish": the legal ownership – and the allocation of revenues – of an intangible asset created in country A (say, in Palo Alto, California) is domiciled in an empty shell company in an unrelated country B (Ireland). However, we should not expect any fundamental change to the way transfer pricing is to be conducted and the OECD's much preferred Arm's length Principle which treats MNE's entities *as if* they were independent from each other.
- Country-by-country reporting: MNEs will have to report to tax collectors the geographic distribution of taxes, revenues, number of employees and assets for each country where they operate. This is a considerable step forward, because it would help national tax collectors have a comprehensive view of the MNE and allow them to spot any inconsistency in the allocations. The OECD only considers filing of the reporting with tax administrations. Public disclosure, or even partial disclosure, is not under consideration, despite being required already by other similar reporting frameworks in Europe[3] and in the United States[4].

Other BEPS deliverables are aiming at addressing:

- "harmful tax practices" and the mutually destructive race to the bottom between governments that pile on tax incentives to attract foreign investors (i.e. "patent box" regimes) and the secretive "rulings" between a tax authority and an individual MNE (i.e. the tax deal between Apple Inc. and the Irish authorities which is under investigation by the European Commission);
- "treaty shopping" through the use of an empty shell company to unduly access the tax benefits of a bilateral tax treaty (i.e. the "Dutch sandwich"); and
- "hybrid mismatches" that allow a single transaction or expenditure to be tax differently in two or more jurisdictions to artificially reduce the corporate tax income base (i.e. the USD700m tax evasion schemes set up by Barclays and KPMG between 2002 and 2007 under a US-based scheme called "STARS").

It is too early to form a definitive judgement on whether or not the BEPS will effectively meet public expectations. But some key points of concern that have surfaced include: the fact that no public disclosure of the country-by-country reporting is envisaged, but also the acknowledgement by the OECD itself that uncertainty remains with regard to the tax treatment of banks, shadow banking and of private pools of capital.

## Business views

Unsurprisingly, business groups, tax lawyers and auditing firms have so far shown fierce resistance to any ambitious outcome of the BEPS Action Plan. Their participation in the numerous consultation rounds has been massive with over 400 pages of comments being submitted by business groups alone in the last round on the digital economy[5]. Alongside traditional lobby groups, the business voice is heard through non-financial MNEs (such as Rio Tinto, Procter), global banks and asset managers (Black Rock), audit firms (PwC, KPMG & Deloitte) as well as a mysterious "Digital Economy Group" represented by the law firm Baker & Mc Kenzie, but which membership is kept secret.

A part from classic points on minimising the BEPS phenomenon ("a few black sheep", "don't throw the baby with the bath water", etc.), business arguments include:

- BEPS is about revolution, it will depart from "50 years of international consensus" and that is simply too much to accept;
- Paying tax is a business that is subject to market forces. Because of globalisation, cost pressures on MNEs are high and increasing. Like other expenditure categories, tax costs should be minimised, rightly so.
- It's the fault of the governments who indirectly facilitated BEPS problems. Companies simply comply with the rules.
- The real focus should be on increasing tax certainty, facilitating arbitration and tax deals between individual MNEs and tax administrations.
- In the end, the best way to reduce the risk for BEPS is to agree worldwide on a corporate income tax of 15%.

Business groups are also strongly opposed to a number of specific BEPS measures. We are warned that foreign direct investment flows would vanish should there be any restriction to debt service deduction from the corporate income base (a key deliverable on "hybrid mismatch"), or to offshore bank accounts (key to eliminate "treaty shopping"), particularly in developing countries. Naturally business groups are flatly opposed to any possible form of public disclosure of the country-by-country reporting framework.

### The voice of NGOs and the developing world

So far, the BEPS process has appeared very much as a bilateral confrontation between G20 tax authorities and OECD-based business. But NGOs are doing their part in trying to counterbalance pressure from business lobby groups, including via the BEPS Monitoring Group (BMG), the Tax Justice Network and NGOs such as ActionAid, Oxfam, the French CCFD, Brussels-based EURODAD and the Washington-based Global Financial Integrity.

The low level of involvement of developing countries in the process – other than the big emerging economies from the G20 – is of particular concerns. Lack of harmonisation of tax systems, weak institutional capacities of tax administrations, growing role of (tax-free) special economic zones and incomplete legislation create as many BEPS opportunities in the developing world as possible. The fact that less than 1% of development aid is spent on tax administration capacity building does not help either.

### Why it matters for trade unions

Tax avoidance harms government finance and the right to public services through the net loss in tax revenues. But it also directly affects workers' rights. Trade union experience shows that aggressive tax planning is just another form of corporate "regulatory planning" with short term goals. For example, illicit transfer pricing typically reduces profit levels in subsidiaries that are employment intensive. When a business restructuring for tax planning purposes leads to the splitting of a single company into separate entities, workers have reduced access to information. A trade unionist of the French subsidiary of Colgate perfectly captured why tax planning matters for trade union action: "the farther you are from where tax is being declared within the MNE group structure, the higher the risk for worker misery". Knowledge about tax planning practices is therefore crucial and should become an integral part of trade unionists toolbox. If you want to know what your employer intends to do in the future, ask for the tax filings…

That is why trade unions need to get involved and monitor closely the implementation of the BEPS Action Plan and to campaign with their respective governments for an ambitious outcome. The test for that, in the 12 months remaining of the implementation, might be found in three key advocacy points: (i) obtaining some form of public disclosure of the country-by-country reporting framework, (ii) ensuring that the voice, and the specific challenges of developing countries are taken on board, and (iii) effectively addressing the gaps in the tax treatment of the shadow banking and private pools of capital.

Beyond that, it would be important to broaden the coalition for an ambitious BEPS Action Plan beyond civil society groups and to engage with relevant responsible investment forums, where workers' pension funds are vocal. They too would benefit from greater corporate tax transparency, including public disclosure of country-by-country tax reporting.

By opposition, it would be wrong to blame the BEPS for not delivering what it is not designed to. Discussions on a new global tax governance system or on the fundamentals of the residence versus source taxation debate are entirely legitimate to address. But they are not part of the package and it would be a political mistake to bring these in the BEPS discussions. Business groups would surely be too happy for this to happen. Let's stay focused on the BEPS Action Plan, and the key deliverables. We have 12 months for that!

1 http://www.oecd.org/tax/beps.htm

2 02/10/2014| OECD Mid-Term Reports on the Base Erosion and Profit Shifting (BEPS) Action Plan - Comments by TUAC (http://www.tuac.org/en/public/e-docs/00/00/0F/57/document_doc.phtml)

3 Revised EC Accounting and Transparency Directives (June 2013) and Capital Requirement Directive (CRD IV, article 89) applying to the extractive industry and to banks respectively.

4 section 1504 of the Dodd-Frank Act covering SEC-listed companies in the extractive industry.

5 (http://www.oecd.org/tax/comments-action-1-tax-challenges-digital-economy.htm)

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