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actionaid

The BEPS process: failing to deliver for developing countries

In 2013, spurred by revelations of tax dodging by some of the world's biggest corporations, public anger grew at the injustice of the current global tax system.

G8 governments responded by promising to make the international tax system fairer and to close the tax loopholes that help big companies avoid paying tax. As part of this, the G8 and subsequently the G20 made a strong commitment that these changes would benefit developing countries, which are currently systematically deprived of tax revenue by corporate tax dodging. This revenue could pay for the schools, hospitals and roads those countries need.

To tackle these injustices, the G8 and G20 mandated the Organisation for Economic Co-operation and Development (OECD) to lead on the 'base erosion and profit shifting' (BEPS) process which aims to update the international tax system. Yet a year into the process we see that it is not delivering on the promises made to developing countries. This is for three main reasons: BEPS sidesteps some important issues for developing countries, poor countries are not at the decision-making table, and the BEPS actions so far are weak.

In light of this, ActionAid asks G20 and OECD governments to:

- ImpImplement the agreement reached in their 2013 meeting to carry out thorough and well-resourced 'spillover' analyses, looking at the negative effects of their own countries' tax rules on other countries, especially developing countries.[1] (as already carried out by the Netherlands and Ireland).
- Acknowledge that the BEPS process is unlikely to produce the results that developing countries need to adequately protect their tax bases, and articulate a timeline for the further reforms that will be needed after the BEPS process is concluded to ensure this is addressed. Negotiating such reforms should include developing countries as equal negotiating partners.
- Recognise that there are other bodies with wider international reach – such as the UN Committee of Experts on International Co-operation in Tax Matters – where important discussions on the future of international tax rules are taking place and consider actively boosting the UN Committee's funding and status.

Additionally, ActionAid asks all governments to:

- Review and update their tax treaties to ensure that they do not encourage profit shifting from or to third countries
- Review their current tax incentive policies and ensure that they are not harmful to the tax intake of their own country or that of others

1. http://www.mofa.go.jp/files/000013928.pdf

The UK government must carry out a thorough and well-resourced 'spillover' analysis, looking at the negative effects of the UK's own tax rules on other countries, especially developing countries

Background

In part as a response to the public outcry over corporate tax dodging in recent years, the G8 meeting in Lough Erne in 2013 committed to reform the international tax system.[2] The G8 countries promised that such reforms would benefit developing countries. The G20 declaration in St Petersburg 2013 also stated specifically that "developing countries should be able to reap the benefits of a more transparent international tax system".[3]

Following the Lough Erne commitments, in July 2013 the Organisation for Economic Co-operation and Development (OECD), a grouping of 34 of the world's richest countries, was tasked with negotiating the new rules and launched an Action Plan on Base Erosion and Profit Shifting (BEPS). This identified 15 specific actions they saw as necessary to equip governments with the domestic and international instruments to address various forms of tax dodging.

The BEPS process is planned to take two years, with the first set of recommendations coming out in September 2014. There are already strong indicators that these recommendations will not deliver on the promises made by the G8 last year, and in particular that they will not work for developing countries. This is because BEPS sidesteps some areas of importance to developing countries, they are not at the decision making table, and the changes proposed so far are not in their interests.

How are developing countries affected by tax dodging?

Tax dodging is a major problem for developing countries. For example:

- The OECD Secretary General has said that developing countries lose up to three times the global aid budget to tax havens.[4]
- Global accountancy firm PricewaterhouseCoopers (PWC) estimates that developing countries could increase corporate tax revenues from multinational companies by over 40% by tackling transfer mispricing.[5] [6]
- Zambia estimates that it is losing US$2bn a year in tax revenues due to tax avoidance.[7]

Tax dodging thus erodes the revenue base of developing countries, depriving them of the tax contributions they need to meet the needs and rights of their people, and fund their own development, paying for essential services like schools and hospitals, and infrastructure such as roads and electricity.

A bigger tax base would eventually make them less dependent on foreign aid. Finding ways of preventing tax dodging is therefore a key development issue and should be treated as such in international fora where tax rules are negotiated, as well as at international fora where development and human rights are discussed.

2. See https://www.gov.uk/government/publications/g8-lough-erne-declaration/g8-lough-erne-declaration-html-version for further details.
3. https://www.g20.org/sites/default/files/g20_resources/library/Saint_Petersburg_Declaration_ENG_0.pdf
4. http://www.theguardian.com/commentisfree/2008/nov/27/comment-aid-development-tax-havens
5. http://ec.europa.eu/taxation_customs/resources/documents/common/publications/studies/transfer_pricing_dev_countries.pdf
6. 'Transfer mispricing' generally refers to trade between related parties at prices meant to manipulate markets or to deceive tax authorities.
7. http://www.bloomberg.com/news/2012-11-25/zambia-says-tax-avoidance-led-by-miners-costs-2-billion-a-year.html

Despite attempts to provide space for developing countries' needs, the current international tax system is still dominated by the outcomes of negotiations between OECD member states – the world's richest countries.

BEPS is not working for developing countries

The BEPS process deals with the rules around 'base erosion and profit shifting' – in other words, corporate tax avoidance – which is important for developing countries. However, the emphasis appears to be on issues of current primary concern to richer countries, such as the tax issues thrown up by the rise of the borderless digital economy.

At the same time it fails to deal with how the tax base from multinational companies is shared out between countries – residence versus sources taxation - even though this is of vital importance to many developing countries. In fact, the BEPS Action Plan explicitly states that its actions "are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income".[8]

The distinction between residence and source taxation can be defined as whether you tax money where it is earned (source taxation) or where the person or company earning the money is based for legal purposes (residence taxation).[9] This creates a natural tension between the interests of those countries where most multi-national companies reside (usually in rich countries) and developing countries, which are more likely to be source rather than residence countries for taxation purposes. Addressing the current imbalance between source and residence taxing rights, currently skewed in favour of residence taxation, would be very valuable for developing countries.

In mid-2014, the OECD itself acknowledged in a report looking at the impacts of the BEPS negotiations on developing countries[10] that the benefits to poor countries would be limited. It attributes this partially to a lack of legislative and administrative capacity in poor countries, but also acknowledges the BEPS process' limited scope to address some of the issues most pertinent to developing countries, including tax incentives that lead to a harmful 'race to the bottom'[11] where countries constantly undercut each others' tax rates in order to attract investment in a way which limits the tax intake for all states involved. To address this, the OECD tentatively suggests, however outside the remit of the BEPS process, that poor countries develop better guidance on assessing the costs and benefits of tax incentives to inform policy formulation and enhance regional co-operation to avoid harmful tax competition.[12]

Despite not being designed in their interests, the BEPS process will nonetheless have an impact on poor countries. While developing countries are not formally obliged to adopt the outcomes of the BEPS process, non-OECD countries have sometimes come under pressure to adopt OECD standards, e.g. with regard to transfer pricing guidelines and OECD-model tax treaties.

For example, when the OECD developed the OECD-model tax treaty in 1965, its Fiscal Committee said explicitly that the OECD model *"may not be equally appropriate in treaties between developing and industrialized countries because income flows are largely from developing to industrialized countries and the revenue sacrifice would be one-sided"*. For this reason, an alternative model treaty, designed with developing countries in mind but based on the OECD

8. See p.11 http://www.oecd.org/ctp/BEPSActionPlan.pdf
9. See http://www.taxjustice.net/cms/upload/pdf/Source_and_residence_taxation_-_SEP-2005.pdf
10. See http://www.oecd.org/tax/tax-global/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf
11. See p. 21 http://www.oecd.org/tax/tax-global/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf
12. See p. 23 http://www.oecd.org/tax/tax-global/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf

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model, was formulated by the United Nations in the late 1970s.

Recent research by the International Bureau of Fiscal Documentation shows that, in the large majority of cases, where the two model treaties differ it is the OECD-model provision that tends to prevail in negotiations between developed and developing countries.[13]

Additionally, in 2011, the OECD Secretary General clearly highlighted the de facto status of the OECD model as the global standard for all countries: *"The OECD Model Tax Convention…has been a crucial tool to help create a level playing field in the world economy.…Its quality led it to acquire universal reach. Today, more than 1,500 treaties worldwide are based on the Convention – only one quarter (350) of them are between OECD member countries."*

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Developing countries are not at the table

Excluded from the negotiating table

Despite the G20 commitment to making the new tax rules work for developing countries, they have not been part of the BEPS negotiations as equal partners. A process to reform international tax rules that includes only 34 of the world's wealthiest countries (the OECD members), and excludes over 150 countries, cannot deliver solutions that work for all countries, or indeed the majority of their populations. While consultations that the OECD is organising with non-OECD countries are welcome, they are not a substitute for a seat at the table in the BEPS negotiations themselves.

When looking at the medium to long-term architecture of the global tax system, the international community should look beyond the OECD to other avenues for negotiation and decision-making. This includes the UN Committee of Experts on International Co-operation in Tax Matters[14] which has a broad mandate that includes looking at the situation of developing countries, and has an alternative set of tax rules more beneficial to developing countries than those of the OECD.

Corporate resources to engage with BEPS process outstrip those of developing countries

While developing countries have not been at the decision-making table, the BEPS process has had a lot of input from companies, potentially skewing the outcome of the process from one which could benefit countries' ability to tax corporate activity in a fair way to one which preserves existing loopholes in international tax law, and even creates new ones.

Some of this is due to the enormous capacity and resources that companies use to influence the process. An example of this is the response rate to a consultation on country-by-country reporting (i.e. companies disclosing how much tax they pay and where) organised by the OECD, where 87% of the submissions came from the business sector.[15] The overwhelming majority of those business submissions were against both country-by-country reporting being made available to the public, and country-by-country reporting itself.

13. http://www.un.org/esa/ffd/tax/ninthsession/CRP18_UNModel.pdf

14. See http://www.un.org/esa/ffd/tax/

15. See http://www.oxfam.org/sites/www.oxfam.org/files/bp185-business-among-friends-corporate-tax-reform-120514-en_0.pdf

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In a similar consultation on the proposed action on hybrid mismatches[16] nearly 93%of submissions were from the business sector. Meanwhile, 95% of responses to the consultation on treaty abuse came from the business sector, including companies such as Russian oil giant Gazprom, global accountancy firms KPMG, Ernst & Young and Deloitte, and corporate giants such as AstraZeneca and Intercontinental Hotels.

While it is perfectly legitimate for these companies to engage with these processes, the sheer ratio of business submissions versus non-business submissions is telling of the power dynamics at play within the BEPS process.

Moreover, there are indications that the corporate lobby may be effective. Subsequent to the consultations, the OECD dropped a proposal that country-by-country reporting be made public, something which accountancy company KPMG's Swiss branch hailed as "good news".[17] The imbalance between corporate influence and developing country influence is highly problematic if BEPS is to create a fairer tax system that works for poor people and poor countries.

G20 selling access and influence over tax reforms

Furthermore, in May 2014, it was reported that Australia's G20 presidency had effectively sold access to the G20 International Tax Symposium in Tokyo on May 8 and 9. This consisted of corporate sponsors paying up to A$100,000 for places as speakers on panels, influence over who the other speakers at the event would be and an invitation to an 'exclusive event such as a dinner, lunch or cocktail party'.[18] Those who took up the offer, and were thus given influence over an important G20 forum discussing the future of international tax rules, included Deloitte, PricewaterhouseCoopers and KPMG.

These global accountancy firms have a clear interest in maintaining the current state of affairs. For example in 2013, ActionAid revealed that just two weeks before the G8 meeting in Lough Erne, Deloitte provided information on how to structure businesses via Mauritius in order to avoid tax across parts of Africa to a number of big businesses at an international business conference, thus depriving some of the world's poorest countries of valuable tax revenue.[19]

Overall, the BEPS process appears to be one where the world's poorest nations are not involved as equal negotiating partners and where big business has a disproportionate influence. The outcomes of such a process cannot be considered balanced and legitimate in shaping the future of international tax rules.

The BEPS actions are weak

BEPS has 15 action areas where new rules are being negotiated. Some of these will be addressed in 2014, and others in 2015. Unfortunately, indications are that those currently being addressed are not being dealt with in a way that will have much benefit developing countries.

16. Hybrid mismatches are arrangements exploiting differences in the tax treatment of instruments, entities or transfers between two or more countries. This often leads to double non-taxation.

17. http://blog.kpmg.ch/beps-cbc-reporting-good-news/

18. http://www.smh.com.au/business/accounting-giants-fund-g20-tax-talk-20140525-38wqv.html

19. http://www.actionaid.org.uk/sites/default/files/publications/deloitte_in_africa_1.pdf

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Harmful tax practices

Action 5 of the BEPS project aims to address harmful tax regimes, but it does so by using a very narrow definition what they are. While the OECD definition of a harmful tax regime focuses on secrecy and whether tax rules are ring-fenced from the domestic economy,[20] ActionAid believes that the definition of a harmful tax practice should be wider, and encompass further harmful international impacts of tax rules and treaties to fully encompass the harmful tax practices that erode developing countries' tax bases.

Harmful impacts of national tax rules on other countries, furthermore, are very important – such potential 'spillover' impacts should be assessed and measured for new rules and agreements. It is disappointing that the work on harmful tax regimes as part of BEPS is so narrow in scope given how important harmful tax practices are in threatening tax bases globally. Some of these kinds of practices are addressed in other actions – for example weakened controlled foreign company (CFC) rules will be addressed in 2015 in **Action 3**.

However other harmful practices may not be – for example, patent boxes[21] and royalty taxation regimes that skew the international distribution of taxable income by artificially shifting disproportionate amounts of profit from source to residence countries, but also to third countries not directly involved in the production and services that generate the taxable profit in the first place.

Furthermore, the BEPS work on harmful tax regimes lacks transparency. Our understanding is that there will not be any discussion paper or consultation on this action, and discussions around this are taking place behind closed doors, Without the world's poorest nations at the negotiating table, the outcomes of this important action is unlikely to be effective for them.

Impractical solutions

In some cases the solutions proposed by the BEPS process are too complex and resource intensive to benefit developing countries given the capacity and resources they have at their disposal. For example, as part of its work on **Action 6** on treaty abuse, the OECD released a paper with draft proposals on the issue in March 2014. The OECD proposals to address tax treaty abuse are over-complicated and restricted to technically complex measures that place the burden on the state to prove wrong-doing and risk tying up countries – particularly less well-resourced countries – in endless legal disputes that are unlikely to do anything to address the systematic problem of profit shifting.

Additionally, the draft seems to create new loopholes for 'treaty shopping' – the practice of structuring a multinational business to take advantage of more favourable tax treaties available in certain jurisdictions. This is done through additions to the rules for 'limited benefits' that effectively mean multinational companies can more easily set up conduit holding companies in tax havens that have tax treaties with source countries in order to lower the company's overall tax bill.

Overall, what emerges is a picture of a process that lacks transparency on important issues and whose recommendations are unlikely to be suited to the needs and capacity of developing countries.

20. See http://www.oecd.org/tax/harmful/37446434.pdf

21. A Patent Box enables companies to apply a lower rate of Corporation Tax to profits from its patented inventions and certain other innovations.

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Conclusions

The BEPS process is a first step towards creating a fairer and more effective international tax system for OECD and G20 countries. However, further reforms to both national and international tax rules will be needed beyond the BEPS process to ensure that tax dodging is properly addressed, especially for poorer countries. It is therefore important for governments both inside and outside the G20 to start thinking about what comes after the BEPS process. If the international tax system is truly to be fixed to ensure developing countries are able to collect corporate tax revenues effectively, harmful tax practices and tax regimes will need to be addressed in a meaningful, public and accountable way.

An Expert Group on tax set up by the European Commission concluded in late May 2014 that "the G20/OECD BEPS project […] to a large extent takes the existing international rules to determine and allocate the corporation tax base as a given. These international rules will be amended within the international tax framework. The EU, however, should also consider a more fundamental review of international corporation tax mechanisms, including a consideration of both the allocation of the right to tax and the most appropriate base for corporation tax.[22]"

ActionAid believes developing countries need a fundamental rethink of the tax system's architecture if it is to work for them in a fair way, not a cosmetic tinkering with the current rules. What the current BEPS process adds up to is a potential slight improvement of current tax rules without questioning that as the basis for the current international tax system itself, and the main reasons why it doesn't work.

In light of this, ActionAid asks G20 and OECD governments to:

- Implement the agreement reached in their 2013 meeting to carry out thorough and well-resourced 'spillover' analyses, looking at the negative effects of their own countries' tax rules on other countries, especially developing countries.[23] (as already carried out by the Netherlands and Ireland).
- Acknowledge that the BEPS process is unlikely to produce the results that developing countries need to adequately protect their tax bases, and articulate a timeline for the further reforms that will be needed after the BEPS process is concluded to ensure this is addressed. Negotiating such reforms should include developing countries as equal negotiating partners.
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22. http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf
23. http://www.mofa.go.jp/files/000013928.pdf