GLOBAL ALLIANCE FOR TAX JUSTICE

The BEPS Monitoring Group

Mr Pascal Saint-Amans, Director, Centre for Tax Policy and Administration, OECD
cc: OECD Committee on Fiscal Affairs

June 12, 2015

Re: Key Points on Tax Issues for G20 Sherpas Meeting June 2015
G20 and OECD must act to prevent failure of the BEPS project

Dear Mr. Pascal Saint-Amans,

As you know, civil society organizations active on tax justice have been closely following the progress of the BEPS project. Detailed comments have been submitted on individual discussion drafts, especially by the BEPS Monitoring Group.

We have now drawn up a general statement on the current state of play, attached to this letter. It has been coordinated through the C20 and will be presented next week to the G20 sherpas. It has also been approved by the Global Alliance for Tax Justice on behalf of all its regional networks and their member organizations.

We would be grateful if you could forward this to the Chair of the Committee on Fiscal Affairs for consideration by all the participants in the BEPS process.

Yours sincerely,

Martina Neuwirth
Member of the Coordination Committee of
Global Alliance for Tax Justice (GATJ)

Key Points on Tax Issues for G20 Sherpas Meeting June 2015

These are the issues on which civil society would like to see progress on the three main topics related to tax which are G20 concerns.

Corporate and Financial Transparency

- Beneficial Ownership
  - Fulfilment by G20 members of their pledge to establish beneficial ownership (BO) registries; the EU's recent Anti-Money-Laundering Directive is a significant step towards this, though questions remain about (a) trusts, and (b) access to the data by interested persons.
  - G20 members should also extend BO registries to their dependent territories.
  - The G20 should consider how to extend the BO registry system to all jurisdictions worldwide.
  - G20 should ensure that all BO registries are public.
- Automatic Exchange of Information (AEoI)
  - Unless there is a viable process for developing countries to easily participate in AEoI, the G20 promise that the 'era of bank secrecy is over' will be broken.
  - The Global Forum Roadmap report to the Development Working Group identified the main problem in the need to reduce costs and increase benefits of AEoI to developing countries. What is now needed is more ambition in the solutions:
    - A clear commitment to a multilateral mechanism – Switzerland has said it will only provide information to powerful countries, this cannot be allowed to happen.
    - A transitional mechanism to allow developing countries to focus on realising benefits from receiving information while adapting to the requirements to send information.
    - All participants to collect and publish annually statistical data on the aggregate sums passing through their financial system, broken down by country of residence of the account holder and of controlling persons.

The Action Plan on Base Erosion and Profit Shifting (BEPS)

The St Petersburg Declaration committed the G20 to reforms that would ensure that multinational enterprises are taxed 'where economic activities take place and value is created'. The only way to deliver on this commitment is through strong rules to deal with the reality that global MNEs are integrated firms under central direction. The current proposals fall short of this. A longer analysis of the current state of play is provided in the Annex, our main concerns are:

- Strong standards are needed, but currently not forthcoming, especially for:
  - rules governing Controlled Foreign Corporations (CFCs);
  - limitation of interest deductions, which should not be greater in aggregate than the corporate group's consolidated interest costs to third parties;
  - harmful tax practices, including effective monitoring and information sharing, and collective defensive mechanisms.

- The extensive revisions of the Transfer Pricing Guidelines will make them even more complex and confusing, adding to compliance costs for both tax administrations and business, benefiting only tax advisers. The revised Guidelines should be regarded as only provisional, and a more fundamental reconsideration should be begun, in conjunction with the UN, to provide Guidelines based on treating MNEs according to the economic reality that they are integrated firms, and provide clear and simple rules for allocating profit to where real economic activities take place.
- Although the template for Country by Country Reports is good, the threshold of 750m euro is too high. The arrangements for filing and access are also weak, all countries need access to these reports, yet that is currently not going to happen. There is no convincing argument to suggest these reports would contain commercially confidential information and hence they should be published. This would facilitate research and analysis of whether the international tax rules are meeting their stated objects, and reassure the public.
- An appropriate follow up mechanism is necessary to monitor implementation of BEPS project outcomes, including through the proposed Multilateral Convention; it is essential that this mechanism should provide adequate representation of all states, and participation of civil society.

Ensuring Benefits for Developing Countries

We appreciate the efforts of the OECD and G20 to involve others especially developing countries, and the efforts of the Development Working Group, but these cannot substitute for a truly inclusive global forum. Therefore:

- A universal intergovernmental body under the auspices of the UN should be established and be provided with additional resources to establish a truly global forum for international tax matters.
- The UN Tax Committee and other relevant bodies should strengthen their work to ensure that developing countries can protect their corporate tax base.
- There should be specific actions to build capacity in developing countries for both international tax policy and tax administration, but the reformed international tax rules should be easier for all countries to administer; it would be a misuse of resources to provide capacity building and toolkits for developing countries to operate rules which are defective.
- To acknowledge the damage that harmful tax incentives can play, the G20 should adopt a High Level Declaration against Harmful Tax Practices, which should include commitments for increased transparency of incentives, a review of their own incentives to assess impact on developing countries, and provision of assistance to developing countries to eliminate their own harmful incentives.

G20 and OECD must act to prevent failure of the BEPS project

Civil society organisations were encouraged by the G20's efforts to reform the international tax system, and its mandate to create a foundation for international tax rules suited for the 21st century. However, following the G20 International Tax Symposium in Istanbul, we have become concerned that the package of proposals being negotiated in the project on Base Erosion and Profit Shifting (BEPS) could make an already bad situation worse.

The G20 world leaders in 2013 mandated the BEPS project to produce reforms of international tax rules which would ensure that multinational enterprises (MNEs) can be taxed 'where economic activities take place and where value is created', and that developing countries should also be able to benefit. For civil society, increasing public revenue through progressive taxation is crucial to finance essential public goods, services and investments, for fighting inequality, and for ensuring implementation of the sustainable development goals (SDGs). The BEPS project has the potential to put an end to tax avoidance by multinational enterprises through tax havens, and so help to raise corporate tax revenues in developing countries and developed countries alike. Further measures are also needed which go beyond the BEPS project itself, including the priority issues identified by the G20 Development Working Group such as indirect transfer of assets, lack of comparables and wasteful tax incentives, but also the overall balance of taxing rights between source and residence countries.

For the BEPS project to realise its potential and simultaneously deliver on multiple policy goals in an integrated and consistent way, the current proposals would need to be further scrutinised and revised. The final package of proposals is currently under discussion and being put together for final presentation to G20 Ministers of Finance in October and G20 Leaders in November 2015. Civil society organisations share the view that the G20 and other participating countries should use the remaining months to improve the package, address the weaknesses in current proposals, and provide solutions that work for all countries.

The project has been led by what is often referred to as the "rich countries' club", the Organisation for Economic Cooperation and Development (OECD), with the added participation of other G20 countries, and more recently some other developing countries and regional tax administration networks. There have been consultations on most of the draft proposals, yet these discussions have generally been dominated by representatives of big business and lobbyists from the tax avoidance industry. Although outgunned by other interest groups, civil society has provided detailed and constructive comments on all the proposals. However, civil society organisations are concerned that these comments and similar concerns raised by the developing countries are largely being ignored. Further negotiations about international tax standards, beyond the conclusion of the current BEPS package, urgently require an all-inclusive approach, where all governments participate on an equal footing. Therefore we are also calling for reform of the governance of international cooperation in tax matters.

The position of many developed nations to keep negotiations on tax within the OECD has been justified by the arguments of efficiency and the potential for stronger decisions, which we do not accept. In fact, it would appear that reaching consensus is leading to an agreement on the lowest common denominator, which would result in a watering down of the proposals. Such a weak outcome would be harmful for all, as weak coordination of the international tax system undermines every country's ability to apply effective tax rules to MNEs, and hence its sovereignty.

The result could be worse still, if it creates an international consensus based on ineffective and inappropriate rules which states feel bound to follow. The issues on which the civil society organisations consider the proposals could be weak, inappropriate or even damaging include:

(i) A standard for limitation of interest deductions allowing a wide range of options, making it hard for countries wanting to attract investment to set limits strict enough to stop MNEs from continuing to export millions of dollars in untaxed profits through interest payments to related parties.

(ii) Weak rules on Controlled Foreign Corporations, which would continue to encourage MNEs to shift income out of operating affiliates in source countries and park them untaxed in countries with lower effective tax rates, so encouraging a continued race to the bottom in tax.

(iii) Only minor revisions to the definition of taxable presence (the Permanent Establishment test), inadequate to a world of rapid and digitalised communication, in which sales can be made and services can be delivered based on close relations with users and consumers but with little or no physical presence in the country. Since some OECD members are already pursuing their own solutions (e.g. the UK and Australia), developing countries should also protect their tax base, for example by strengthening withholding taxes on fees for services, and expanding their definition of permanent establishment.

(iv) Rules on transfer pricing based on the fiction of the ‘arm’s length principle’; this requires tax administrations to conduct time-consuming analyses requiring specialist knowledge to compare MNCs’ internal transactions against reference points that are in reality non-existent or inappropriate. The proposals may include additional “special measures”, and the Guidelines will grow from 350 to closer to 500 pages. While weaker tax authorities will not have the resources to challenge MNEs supported by well paid advisers, in other countries transfer pricing administration will become even more subjective or even arbitrary, generating conflicts both with taxpayers and other authorities. This is a problem for all countries: even the US recently hired outside consultants to help with its audit of Microsoft at a reported fee of $2m. The more complex rules will also increase compliance costs for business, and this will especially hit medium sized enterprises with some international activities.

(v) Anticipating the likelihood of increased conflicts, companies and tax advisers are demanding mandatory binding arbitration of disputes. This would be a totally inappropriate method to deal with divergent interpretations of complex and loosely written rules. While objections from some G20 countries will prevent full adoption of such proposals, some measures to detach interpretation of rules from policy considerations seem likely.

(vi) We welcome the agreement on a template for Country-by-Country reporting. However, the high reporting threshold of 750m euros would exclude many substantial companies whose presence in smaller economies is significant; also, the complex and burdensome arrangements for filing and access which are proposed would restrict dissemination especially to developing countries. We see no valid reason why such reports should not simply be published, as is already the case for similar reports for some economic sectors in the EU and the USA. The efforts to end tax avoidance behaviour by multinationals also need the help and support of civil society which will only be possible with readily accessible published Country by Country reports.

In principle the outcomes would not be binding on states. However:

(i) Many of the proposals take the form of a rewriting of the OECD Guidelines on Transfer Pricing, which once approved will immediately be applied in practice around the world by practitioners and tax tribunals, even if the countries concerned have played little or no part in writing them; in our view the revised Guidelines should be regarded as only provisional, and a more fundamental re-evaluation of them should be begun in conjunction with the UN Tax Committee.

(ii) A Multilateral Convention is being prepared to allow rapid implementation of those proposals which require changes to international treaties; some of these could benefit developing countries, e.g. anti-abuse provisions; but if good and bad provisions are packaged together, countries could become locked into undesirable or even damaging obligations.

(iii) Follow up mechanisms are being prepared without consultation, which will include peer-review to monitor implementation; these could operate to discipline or deter states from applying rules they consider appropriate to their circumstances. Such monitoring will also be limited, as it will not include tax incentives, and the standards on Harmful Tax Practices will remain essentially voluntary, only supervised by an OECD Forum which operates in secret and has proved ineffective.

Follow-up mechanisms should be transparent and include civil society participation as an integral part of the process.

Civil society remains supportive of the efforts to achieve effective reforms of international tax rules. However, we will scrutinise the details of the proposals that are emerging, and provide constructive criticism if appropriate or call for rejection of specific proposals when and if a proposal does not meet the minimum standard of effectiveness especially for developing countries.

Civil society is motivated and encouraged by the objectives set by the G20 itself to create a tax system that is beneficial for all. Fair and effective international tax rules are essential in ensuring competitive equality between large multinationals and the small and medium enterprises which are so important for economic growth especially in emerging economies, and to help meet the objective of domestic revenue mobilisation of developing countries as part of the financing for development agenda. We call on the G20 to ensure that the BEPS process delivers on these objectives, and on all those involved in these negotiations to set aside considerations of short-term advantages to their own country or company, and firmly focus on achieving principled and sustainable reforms to lay a foundation for international tax rules suited for the 21st century.