BEPS MONITORING GROUP  
Summary of Evaluations of BEPS Action Plan Proposals  

The BEPS Monitoring Group (BMG) is an international network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. Its reports are not approved in advance by these organizations, but they support the work of the BMG and endorse its general perspectives. Its aim is to produce reports relating to the reform of the international system for taxation of multinational enterprises (MNEs), with a special focus on the Tax Declaration of the G20 world leaders and the OECD’s project on Base Erosion and Profit Shifting (BEPS), to help inform public discussions, especially in and concerning developing countries.

The following summary is based on BMG submissions prepared by various of our members which are available on our website. Overall, some of the OECD proposals could provide a more effective basis for MNE taxation, especially those which have moved towards treating them on a more realistic basis as unitary firms. Others will increase complexity and rely on detailed and intrusive audits and subjective judgments, and hence be difficult to administer especially by developing countries, exacerbating the likelihood of conflicts.

The template for Country-by-Country Reports (CbCRs) is a major achievement which could transform MNE taxation, giving tax administrations for the first time an overview of the firm and its activities as a whole and in each country. However, the proposed method of filing primarily with the tax authority of the country of residence of the parent, to be shared with other countries only through information exchange mechanisms, creates significant obstacles especially for developing countries; and the refusal to contemplate publication will fail to reassure the public that the reformed system could achieve the G20’s aim of taxing MNEs ‘where economic activities take place and value is created’.

The proposals on abuse of the permanent establishment rules also entail a move away from the independent entity principle, but are limited to (i) situations where a multinational selling in a country has an affiliate or agent involved with conclusion of contracts; and (ii) a proposed anti-fragmentation rule which only covers pre-sales-related activities. This falls short of measures already used in some countries, as well as new ones such as the UK’s Diverted Profits Tax. We advocate revision of Article 5(7) of tax treaties to reverse the presumption that the fact that two companies are under common control shall not ‘of itself’ create a taxable presence for the multinational as a whole.

An apportionment approach has also been proposed to deal with limitation of interest deductions, including the possibility of capping deductions according to the net consolidated interest expense of the group to third parties in proportion to their earnings before interest, tax, depreciation and amortization (EBITDA), which could greatly reduce the opportunities for avoidance by structuring internal lending to inflate deductions of interest from taxable profits. Regrettably, tax advisers are still lobbying for fixed caps, which the OECD report itself showed have been ineffective, as they are always set too high. A similar approach can be seen in the proposal for a ‘simplified method’ for apportionment of central service costs, although this has been limited to Low Value Adding Services. This limitation is understandable, as many tax authorities are rightly concerned that such charges have been used for BEPS purposes, and hence insist on applying a strict benefit test.

Our major concerns are with the confused and contradictory proposals in relation to transfer pricing rules, especially as they could take effect very quickly by adoption of revisions to the
OECD Transfer Pricing Guidelines, which have quasi-legal effects in many countries even outside the OECD. The existing Guidelines already provide for five accepted methods. Additional methods and variations are now being added in the proposals, which will further transform the Guidelines into a labyrinth of variations and possibilities, with a myriad examples of different cases and situations. This will require tax authorities to carry out a detailed ‘facts and circumstances’ analysis of the ‘functions performed, assets employed and risks assumed’ by each affiliate. This approach depends on availability of experts with specialised knowledge of many industry sectors and business models, a totally unrealistic expectation for most countries. Even the most developed OECD members struggle to match the resources of the private sector, as seen by the recent decision of the US IRS to pay $2m to consultants to help with its audit of Microsoft. In our view such an outcome would be extremely damaging, especially for developing countries. It would disadvantage tax authorities which have resource constraints, create uncertainty for taxpayers, and generate conflict as different tax authorities opt for different methods.

In our view, it is important that the move towards a unitary approach should not be limited to apportionment of costs, but also to profits. Hence, we welcome the report on Profit Splits. It is nevertheless regrettable that this method is still seen as a fall-back or to be used only in exceptional cases. Also, more should be done to make this method easier to apply. In particular, we strongly recommend specific allocation keys applicable for common business models, and clear criteria for the formulation of allocation keys in other cases and for new business models. Other methods could also be investigated, such as that by Michael Durst for a ‘shared net margin method’.

Another area on which we have concerns is how to restrain governments from giving tax breaks to MNEs, which is a problem for both developed and developing countries. The BEPS project includes proposals to deal with harmful tax practices, which have been discussed mostly behind closed doors, perhaps to reduce business pressures, but also excluding public debate. The approach adopted is to establish general criteria, and evaluate states’ measures against these. Much depends on the form of enforcement: a voluntary ‘peer review’ procedure would be toothless and end by encouraging states to devise new measures; but if backed by the possibility of counter-measures (either collective or unilateral) monitoring of compliance would be highly intrusive for both companies and states. This can be seen in particular in the current proposals relating to the economic substance criterion for innovation boxes, which involve complex rules and a ‘track and trace’ system for company expenditure. In our view such regimes are unnecessary and undesirable, as encouragement for R&D can already be easily provided through investment allowances. The OECD approach will simply legitimize them, which would be particularly damaging to developing countries, which are often used as manufacturing platforms, encouraging their tax base to be drained by this legitimized profit-shifting. This again clearly shows why a better approach to taxing companies where economic activities take place would be extension of the profit split method. The G20 has also separately asked for a report on restraining developing country governments from offering incentives, which we understand is being prepared by the IMF.

We suggest that this issue be tackled comprehensively as part of an implementation and follow-up plan, which will be essential if the BEPS reforms are to be meaningful, since it requires countries to be willing to accept and apply measures which they may regard as against their ‘competitive’ interests. Appropriate elements from the BEPS proposals should form part of a High Level Declaration against Harmful Business Tax Practices, to be issued with the political commitment of the G20 leaders, and calling for adherence by all states. The aim should be to prevent beggar-thy-neighbour tax policies, which undermine the business tax base and facilitate BEPS practices. Such a Declaration should include
undertakings relating to (i) **Transparency** (disclosure to other tax authorities, and where possible publication, of rulings, and special tax preferences); (ii) **Economic Substance Standards**, and (iii) **Tax treaty anti-abuse provisions** (all states should commit to including an anti-abuse provision complying with the minimum standard in all their present and future tax treaties). It should be backed by a more effective **Monitoring Mechanism**, such as an independent Review Panel for evaluation of whether countries comply with the standards, including: (i) the opportunity for both governments and civil society organisations to refer practices for review, and (ii) regular meetings of the reviewers with civil society in both countries offering and those affected by the tax practices concerned.

The OECD, in conjunction with other organisations such as the IMF, is proposing to prepare **Toolkits** to assist developing countries in implementing the BEPS reforms. These might include some simplified methods, such as ‘safe harbours’. However, in our view it is far preferable to establish clear and simple rules for all countries to apply, which would ensure fairness and reduce conflicts. It is not only the poorest developing countries which could experience major problems, but emerging economies (e.g. Argentina, Peru, Kenya, Turkey), some of them OECD and G20 members, on which hope should rest for a rebalancing and reinvigoration of the world economy. Central to this should be reform of international corporate taxation to end the opportunities for tax avoidance by large MNEs and establish fairer conditions of competition for national small and medium enterprises.