BEPS MONITORING GROUP

BEPS Action 11: Improving the Analysis of BEPS

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This response is submitted by the BEPS Monitoring Group (BMG). The BMG is a group 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. This paper has not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives.

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We welcome this opportunity to comment on the Discussion Draft (DD), and would also be willing to speak at the public consultation on the subject.

Our comments build on our previous submission for the consultation under BEPS Action 11 in September 2014, in which we already highlighted data problems and provided literature references. In the response below, we are not commenting on all methodological details, for example about the treatment of outliers. In our view, the major data constraints that still exist need to be addressed first. Furthermore, additional methodologies for specific BEPS channels should also be further explored before discussing the details of specific methodologies.

1. GENERAL REMARKS

Thorough, timely and comprehensive analysis of BEPS is indispensable to make the BEPS project a success. Thorough analysis, based on reliable data, is essential to monitor the effects of BEPS measures. The analysis must be timely to enable the OECD and individual jurisdictions to respond quickly to new and unforeseen issues that may arise as the package of BEPS recommendations is implemented. The analysis must also be comprehensive in the sense that it covers the full operations of relevant large multinational enterprises (MNEs), in OECD as well as non-OECD countries.

Obviously, the impact of tax avoidance by MNEs on tax revenues is a concern for all states. It is particularly important for developing countries, though, since most of them rely more heavily on revenues from corporate income taxes. Thorough analysis of BEPS can help these countries to focus on the most important BEPS problems. However, it should be remembered that there are also much wider potential benefits from the BEPS project. These include:

> (i) ensuring competitive equality between MNEs and national businesses, and restoring confidence of all taxpayers in the fairness of tax systems;

> (ii) ensuring fairness also for firms less willing to engage in aggressive tax practices, or in economic sectors where there are fewer opportunities to do so;

> (iii) removing the incentives for MNEs to devote enormous resources to paying for tax advisers and the complex structures and entities that BEPS tax avoidance requires, and making international tax rules clearer and easier for tax authorities to administer;

> (iv) ending the use by MNEs of tax havens and the offshore finance and secrecy system, which also facilities a wider range of abusive tax practices, capital flight and money laundering.

Thorough, timely or comprehensive analysis of BEPS is currently not possible due to data limitations. The discussion draft provides a very useful discussion of data sources and methodologies and rightly concludes that availability of comprehensive and reliable micro data is a major constraint. Additional disclosure requirements for MNEs are crucial to ensure that such data become available. The same applies to bilateral macro data; these require primarily an effort by governments to collect and report better statistics.

Enhancing possibilities for analysis of BEPS requires revisiting the implementation of country-by-country reporting requirements under Action 13. We understand that the OECD is committed to ensure that the final set of BEPS Actions, to be presented towards the end of the year, will be a coherent package. There is an urgent need to enhance coherence between Action 13 and Action 11 in the final package. We discuss this in more detail below.

2. ASSESSMENT OF EXISTING DATA SOURCES

We agree on the criteria for assessing data for analysis of BEPS. Currently, there are no sources that meet all these criteria. Data coverage on the operations of MNEs in developing countries as well as in tax havens is especially problematic. Without such data, it is impossible to thoroughly assess to what extent the allocation of income is aligned with the economic activity that generates that income. Although there may be possibilities to assess various individual BEPS channels on the basis of aggregated data, micro data on the allocation of income and economic activity remains essential to monitor to what extent the overall goal of the BEPS project is being achieved.

The only conceivable dataset that will meet all criteria is the potential dataset that would be created by drawing together the country-by-country reporting of each MNE. This is because all existing micro data sources present an incomplete picture. Multi-country sources, such as Orbis, typically cover only a subset of the subsidiaries of MNEs for those MNEs that are included in the database. While still useful for a partial analysis of profit shifting by smaller MNEs within a specific region, notably Europe, this is insufficient to analyse BEPS by large MNEs that also have subsidiaries in developing countries, tax havens and other jurisdictions that are not covered. Without data on all subsidiaries of MNEs, the global allocation of taxable income and economic activity remains unknown and the results of BEPS analysis would be unreliable. Moreover, for large MNEs with extensive intragroup ownership chains that conduct financing and trade within multiple countries, it is impossible to reconcile the country-level data with the consolidated accounts because of double counting, which further distorts the results of BEPS analysis.

The February 2015 guidance on implementation of BEPS Action 13 therefore needs to be urgently revisited. The guidance is not in line with paragraph 25 of the September 2014 report on BEPS Action 13, which states:*"The country-by-country report [...] may also be used by tax administrations in evaluating other BEPS related risks and where appropriate for economic and statistical analysis."* If the data may be used for economic and statistical analysis, they should also be available for researchers outside of a country's tax administration, including researchers of the OECD. Moreover, the data should become available in a timely manner and be comprehensive. However, under the current proposal, this will not be the case. The guidance on implementation published in February 2015 confirms that*"Jurisdictions should use appropriately the information in the CbC Report template in accordance with paragraph 25 of the September Report."* However, this suggests that either it is inappropriate to monitor global progress against BEPS – a position that can hardly be defended – or the guidance on implementation itself is inappropriate. Three things must be changed in the final BEPS package.

First, country-by-country reporting must be public. We emphasise that making the data publicly available is the best solution to provide access to it for analysis of BEPS. It is simply more efficient for everyone. MNEs will have to report only once according to a single global format. This becomes increasingly important as individual jurisdictions are developing their own public reporting requirements in the absence of an OECD standard for that purpose, such as the EU Capital Requirements Directive. Furthermore, governments will not need to negotiate a large and complex

network of exchange agreements and build new systems to implement exchange of information. This would be especially cumbersome for smaller developing countries and in fact makes the entire Action 13 approach unworkable for them. Another advantage is that researchers will have direct and unrestricted access to all data. As a result, peers will have access to the underlying sources when interpreting and reviewing the results of BEPS analysis.

In our previous submission we already mentioned second-best alternatives, such as storing all country-by-country reporting data in a secured central data system. Staff from the OECD CTPA, IMF FAD, UN Tax Committee, regional tax forums and external researchers could then have full access to all micro data, bound by confidentiality agreements, and be able to publish partially aggregated statistics. It is worrying that the February 2015 guidance on implementation does not even provide for second-best approaches to make the data available to researchers. If some countries continue to block the OECD and G20 from endorsing public country-by-country reporting, the OECD should urgently work on a second-best approach.

Second, the income threshold for country-by-country reporting must be lowered to €50 million or €100 million. For risk assessments as well as analysis of BEPS, it is essential that country-by-country reporting data become available for all MNEs that have the scale to engage in complex and aggressive international tax planning. For this purpose, the proposed threshold of €750 million is far too high. In fact, some BEPS practices are also common among MNEs with a consolidated income of much less than €100 million. In smaller developing countries, a MNE with a global income of €100 million that has operations in a few countries only may be among the largest foreign direct investors. The EU Accounting Directive sets the threshold for large companies at €40 million. Note that lowering the threshold to for example €100 million would not disproportionally increase the number of MNEs that need to report publicly. A preliminary analysis with Orbis data (in the absence of a better source) suggests that only three times as many MNEs would meet the 7.5 times lower threshold.

Third, the deadline for country-by-country reporting must be shortened to 6 months after the end of the financial year. The 1 year deadline suggested in the guidance on implementation is too long for timely analysis of BEPS, which can only start when the data are available, as well as for a timely risk assessment by tax authorities, which typically precedes a more elaborate analysis of selected tax returns. If country-by-country reporting data do not become publicly available or are not directly stored in a central data system, the situation will be even worse, because there will be an additional time lag of several months before the data has been transmitted by all home country tax authorities. A reporting deadline of 6 month would require the country-by-country data to be reported according to the same timeframe as consolidated financial accounts and is therefore entirely reasonable.

Existing bilateral macro data sources should also be used and improved for analysis of specific BEPS channels. These include macro data on bilateral trade in goods, trade in services, foreign direct investment, and foreign direct investment income. We understand efforts are ongoing to enhance and combine existing data sources. We encourage the OECD to make combined data sets publicly available where possible, allowing governments, academic researchers, civil society, and investigative journalists to use these data as well. The following list briefly mentions some specific BEPS Actions and aggregated data sources that can be used to analyse the corresponding BEPS channels.

- Action 6, preventing treaty abuse (and to some extent also Action 3, preventing use of active intermediaries to avoid home-country CFC rules): bilateral data on FDI and relevant income flows or Special Purpose Entities (SPEs), with FDI disaggregated into equity and gross debt components, in line with the 4th OECD Benchmark Definition on FDI.

- Action 4, preventing profit shifting via interest deductions: bilateral data on interest flows and more comprehensive data on the gross debt components of bilateral FDI positions; many data points in the IMF Coordinated Direct Investment Survey are not disclosed and this seriously hinders analysis of BEPS.

- Action 4, preventing profit shifting via other financial payments, such as insurance fees; Action 8, prevent profit shifting via payments related to intangibles, such as royalties; and Action 10, prevent profit shifting via other services payments, such as management fees and head office expenses: bilateral data on trade in services, disaggregated by main type of services.

- Action 10, preventing profit shifting via mispricing of trade in goods, such as commodities transactions: bilateral data on the volume and value of trade in goods, disaggregated by detailed goods classification.

Some countries may also benefit from better use of unique national data sources, but analysis using those data should be left to national researchers. An example of such a source is macro data from the Central Bank of Argentina on the acquisition of foreign exchange for payments relating to for example entrepreneurial services, royalties, freight, and commissions. Such information is publicly available and can be used in a similar way as balance of payments data. It does not distinguish between intragroup and third party transactions, but it can be used for an analysis of the evolution of such payments, using specific methodologies that are suitable for this source. However, as such sources do not provide a global picture, we suggest that the OECD itself focuses on creating, enhancing and using comprehensive global data sets.

Governments should make more existing data publicly accessible to support analysis of BEPS. This includes the annual accounts of individual subsidiaries, which form the basis of larger databases such as Orbis. Making annual accounts accessible also facilitates research on individual MNEs by investigative journalists and civil society, which has helped to expose and better understand BEPS problems, and brings broader economic benefits, such as increasing the amount of information that is available to companies about their clients and business partners. Other data that should be made publicly accessible include micro data on international trade, which is useful for analysis of potential transfer mispricing.

3. POTENTIAL BEPS INDICATORS

The discussion draft lacks overall indicators of misalignment between the allocation of income and economic activity. This is understandable and inevitable, considering the current data limitations. However, we would encourage the OECD to develop simple indicators using country-by-country reporting data in anticipation of such data becoming available for analysis.

The proposed indicators 2, 3, 5 and 7 are problematic because of underlying data limitations. Orbis has a poor coverage of developing countries, tax havens, and various other countries. At the same time, for countries with good data coverage, Orbis does not allow to account for the extensive intra-group positions and transactions of large MNEs. As explained above, this makes the data unsuitable to analyse global BEPS practices of large MNEs. It is tempting to use Orbis because other currently available micro data sources are even less comprehensive, but we strongly advise against it.

If the proposed indicators 2, 3, 4, 5 and 7 use a sample of the largest MNEs worldwide, these indictors may not be very relevant for smaller developing countries. Especially in smaller developing countries, some of the largest foreign investors may not be among the largest MNEs worldwide. Moreover, profit rate differentials between domestic and foreign operations imply a focus on home countries of large MNEs. Analysing such differentials would in fact be a much reduced form of analysing misalignment of profits and economic activity in general, without source country data. Again, the preferred solution would be to make sure that country-by-country data is also available for source countries.

The proposed indicators 1 and 6 are useful to analyse profit shifting to pure tax havens. These indicators are more reliable, as they do not depend on the availability of comprehensive micro data. However, they target pure tax havens only, whereas profit shifting may also take place to countries with a large normal economy that provide opportunities for aggressive tax avoidance as well, such as Switzerland and Belgium, or to countries with special low-tax regimes for income from patents and

other intellectual property. Furthermore, these indicators provide little information about which countries are most affected by BEPS problems, but they would be useful in combination with an analysis of individual BEPS channels that does provide such information.

4. SCALE AND IMPACT OF BEPS AND COUNTERMEASURES

This chapter provides a useful discussion of existing studies and methodologies. Inevitably, it mainly covers research approaches that are either based on partial data or focused on specific countries for which more comprehensive data are available from a country-specific source. Still, the distinction between a tax rate differential approach and a BEPS channels approach helps to clarify the main options.

A tax rate differential approach has some drawbacks. Most importantly, it is difficult to construct a counterfactual on the basis of a robust profit function. It may be especially difficult to estimate the effect of country-specific factors, such as political risk or government policies, that vary over time. Again, availability of country-by-country reporting data would greatly help to estimate expected profits in the absence of BEPS. This could enable country-specific estimates of profit misalignment, which could be very helpful to measure and monitor BEPS.

The large advantage of a BEPS channels approach is that it provides specific and robust policy information. Distinguishing individual BEPS channels helps to focus policy measures and tax audits on those BEPS issues with the largest revenue impact. A BEPS channels approach would also be more robust, because some anomalies such as large royalty payments to a tax haven can be readily attributed to BEPS and hardly depend on model parameters. It would therefore be very useful to monitor individual BEPS channels from year to year for as many countries as possible.

To some extent, constructing a counterfactual is a challenge for BEPS channels as well. It can be difficult to attribute BEPS effects to the right country. Consider for example a domestic subsidiary that makes large interest payments to a tax haven affiliate. It is not always easy to say whether in the absence of BEPS there would have been no interest payments at all (and tax revenue loss should be attributed to the source country) or there would have been some interest payments – probably a lower amount – to a parent company or financing affiliate in another country instead (and the tax revenue loss should be partly attributed to the other country, but it may be impossible to determine which country that would be).

Interaction of BEPS strategies can complicate the analysis of individual BEPS channels. Consider for example a subsidiary in a source country that makes large royalty payments to an affiliate in a conduit country that passes them on to a tax haven affiliate. Without micro data from the affiliate in the conduit country, it is usually not possible to link the payment from the source country to a tax haven, and it may look like a normal payment to an affiliate in the conduit country. Again, enhanced data availability, in this case for example of increased bilateral data on FDI and income flows of SPEs, would allow refinement of the analysis.