The **BEPS** Monitoring Group

Presentation to the Enlarged Framework on BEPS of the OECD Committee on Fiscal Affairs

June 2016

INTRODUCTION

Thank you for the opportunity to speak at this session. I am Professor Kerrie Sadiq from the Queensland University of Technology, here today representing the BEPS Monitoring Group. The BEPS Monitoring Group is an independent network of specialists on international taxation, sponsored by tax justice organisations, concerned especially with the effects of international taxation on development. The positions and ideas expressed here may not necessarily reflect the positions of all the individuals and organisations involved in this network.

DEVELOPING COUNTRIES & THE INCLUSIVE FRAMEWORK

We have three general comments:

First, the BEPS Monitoring Group understands the reluctance of some developing countries towards the Inclusive Framework, if they have not been part of the actual decision making. The inclusive framework expects developing countries to commit to measures which have been already been decided upon primarily by developed countries, and from the perspective of residence countries.[1]

Second, we believe that the UN Committee of Experts on International Cooperation in Tax Matters can play a very useful and important role in international tax reform. Hence, we would urge any OECD countries which are opposed to the upgrading of the Committee to a UN intergovernmental committee to reconsider. An upgrade of status will allow the UN Committee to better complement the work of other ongoing initiatives such as this one, as well as further improving the participation and avenues for voicing the views of developing countries in norm setting for international tax reform.

Third, we are of the view that participation of countries in the Inclusive Framework needs to be tailored to their own situations. This implies careful consideration of the commitments expected of BEPS Associates as well as the adoption of a cautious approach to the obligations imposed by the minimum standards and subsequent commitments. It is nevertheless important for all countries to join in this multilateral effort to ensure that multinational enterprises can be taxed 'where economic activities occur and value is created'.

[1] In the latest OECD Webcast (16 June), it was stressed that the Inclusive Framework would involve four broad areas: standard setting, review and monitoring of implementation, the development of toolkits (8 currently under development), and further guidance on CbCR implementation.

1. THE MINIMUM STANDARDS

The Explanatory Statement on BEPS (Oct. 2015) stated that the minimum standards are in the "areas of preventing treaty shopping, Country-by-Country Reporting, fighting harmful tax practices and improving dispute resolution". These minimum standards were agreed in particular to tackle actions by some countries which would have created negative spill overs. It is the view of the BEPS Monitoring Group that all countries should be expected to comply with standards which are clearly aimed at stopping negative spill-overs, and those which are beneficial for all, but not otherwise. We support the need for consistency on a global basis.

1.1 Model Provisions to Prevent Treaty Abuse (Action 6)

In our view, all countries should commit to model provisions which prevent treaty shopping provided that the drafting of the measures in the Multilateral Instrument is suitable for developing countries. The implementation of Action 6 will necessarily require a suitable framework to be devised under Action 15. All interested countries should be part of this process to ensure that rules meet the needs of developing countries rather than having to implement rules designed by OECD/G20 countries. We also understand that developing countries will be faced with the dilemma that while there are benefits to signing up to most of the multilateral provisions, they may also pose difficulties due to their complicated nature.

1.2 Country-by-Country Reporting and Transfer Pricing Documentation[2] (Action 13)

All countries should commit to CbC reporting. We believe this is one of the most important and major advances in the BEPS program for reform. We would emphasise that it is important for developing countries to have CbC Reports[3] (high level information) to assess all BEPS risks. However, the requirements for a Master File[4] and Local File[5] for transfer pricing documents are also important and developing countries should implement these templates too. All developing countries should ensure legislation is in place which enables their tax authority to obtain this information. Capacity building will play an important role in this and we encourage the continued work on the CbC Reporting toolkit.

1.3 Harmful Tax Practices (Action 5)

All countries should commit to end harmful tax practices and ensure transparency, especially of tax incentives and tax rulings. However, we also believe that countries signing up to the Inclusive Framework should be fully involved in the continuing work on developing the standards. The approach moving forward should be broadened, to help developing countries defend their source tax base. We believe there should be much stricter rules on economic substance and a more binding framework. We believe that a narrow approach does not resolve many of the issues around harmful tax practices. As I will mention in the context of the continuing agenda, we believe that a better approach to taxing companies where

[2] Transfer Pricing documentation is also important as (i) countries can apply the requirements immediately for themselves, and (ii) there is no minimum threshold for the Master File.

[3] The CbC report requires reporting of high-level information relating to the global allocation of a multinational group's income and taxes paid, as well as information about the location and main business of each constituent entity within the group.

[4] The master file provides an overview of the multinational group's business operations that will enable tax authorities to place the group's transfer pricing practices in their global economic, financial, legal and tax contexts. It requires information about the group's organisational structure, its intangibles and intercompany financial activities, its financial and tax positions, and a description of the group's businesses.

[5] The local file focuses on specific transactions between the reporting entity and their associated enterprises in other countries. It requires identification of relevant related party transactions, the amounts involved in those transactions, and the entity's analysis of the transfer pricing determinations that they have made.

economic activities take place would be extension of the profit split method. As we have urged in our other submissions, the use of the profit split method applied with concrete and easily determinable objective allocation keys would be much easier to administer and far less intrusive both for states and enterprises, and would also leave states free to decide their own tax rates, as well as investment allowances.

1.4 Improving Dispute Resolution Mechanisms (Action 14)

In our view, the approach adopted so far, especially as regards a mandatory binding arbitration procedure, is **not** suitable for developing countries, and they should not be expected to commit to this.[6] We hope that a more suitable approach may emerge from the UN Committee. Multinational enterprises are in favour of mandatory binding procedures to be included in the provisions of the multilateral instrument. With some countries[7] already agreeing to mandatory binding arbitration, there is a concern that there will be pressure on other countries, and especially developing countries, to also commit. Our concerns are that countries would be signing up to a system which is dealing with problems caused by vague rules, resulting in decisions involving hundreds of millions of dollars being entrusted to a secret and unaccountable procedure of supranational third party adjudication. Many states, especially developing countries, have had negative experiences of arbitration of investment disputes, and have no wish to follow the same path in the important area of tax.[8]

We are also concerned with any push for developing countries to have a separate competent authority office for the purposes of dispute handling. Many developing countries find it difficult to train the specialist staff to audit multinational enterprises, especially in the complex area of transfer pricing. They cannot be reasonably be expected in addition to establish a separate competent office with equivalent or higher skills. In addition, we are concerned that the criteria for independence in Action 14 stress the need for autonomy of the Competent Authority from the tax administration, but neglects the much more important issue of independence from the private sector.

2. THE CONTINUING AGENDA

2.1 Transfer Pricing (Actions 8-10)

In our view, many of the BEPS changes in Actions 8-10 are unsuitable for developing countries, in particular because they:

- are based on 'functional analysis'9 which requires highly skilled staff, and involves ad hoc and subjective judgments;
- strengthen the tax rights of residence countries, by identifying the key functions as being the 'control' of risk and intangibles;
- hence they would continue to allow MNEs to treat their affiliates in source countries as 'stripped risk' contractors, and entitled to only 'routine' profits,

[6] THE BMG is most concerned about this fourth minimum commitment.
[7] Currently 20 countries. The countries that expressed interest in adopting a mandatory binding arbitration include Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States.
[8] Overall, we encourage developing nations to participate. We do not support mandatory binding arbitration and also think that MAP is difficult for developing countries.
[9] We would argue that a functional analysis is impossible for a developing country to do effectively.

because ‘control’ is elsewhere. Countries such as China and India quite validly argue that the market also creates value; and

- MNEs could continue to use BEPS strategies by locating a few staff in low-tax jurisdictions which they could claim fulfil ‘control’ functions.

The functional analysis approach is complex and difficult to apply, highly subjective, and hence likely to lead to conflicts. If some countries adopt an expanded risk view, issues will be created with residence countries. It avoids the basic problem of how to apportion the profits of multinationals. We believe that new approaches are needed:

- The Toolkit on lack of comparables for transfer pricing purposes (Toolkit #2) should include a strong ‘safe harbour’ rule, allowing developing countries to use a modified net margin method, by applying a benchmark which requires affiliates to show a profit margin proportionate to that of the group as a whole, e.g. of 25% of the group’s rate of earnings before tax.10 This is a modified version of the TNMM;11
- Work on the profit split method should be based on value chain analysis which understands that all parts of an integrated MNE make contributions to the synergy of the group as a whole. It is difficult to justify an approach which continues to attempt to keep the methods within the arm’s length pricing regime. Developing countries should support such an approach; and
- The work of the Task Force on the Digital Economy should include serious investigation of methods such as fractional apportionment.

We are also concerned about the attribution of profits to permanent establishments as many developing countries have a very different view to developed countries. Aligning these rules the proposals on transfer pricing is problematic. The ‘authorised approach’ of attributing profits to PEs using the ‘functionally separate entity’ approach can be exploited since it allows deductions for notional internal payments that exceed expenses actually incurred by the taxpayer. We therefore hope that the continuing work will entail a reconsideration of this approach.

2.2 Defending the Source Tax Base

The scope of the current project specifically excludes any consideration of the allocation of taxing rights between residence and source countries. Several OECD countries have already begun to introduce unilateral measures to defend their tax base, which demonstrates the inadequacy of many of the BEPS proposals, notably the Diverted Profits Tax (for example, the UK and Australia).

The BEPS Monitoring Group believes that developing countries should also be allowed/encouraged to defend their own tax base, notably via:

- suitable withholding taxes; and
- measures to ensure proper taxation of cross-border service provision, e.g. provisions for a Services PE, and/or taxation of fees for services.

[10] The BMG believes that this should be mandatory rather than at the option of the MNE.
[11] See Durst 2016.