COMMENTS RECEIVED ON PUBLIC DISCUSSION DRAFT

BEPS ACTION 11: IMPROVING THE ANALYSIS OF BEPS

13 May 2015
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Dear Mr. Bradbury,

BDI refers to the OECD Discussion Draft “Improving the Analysis of BEPS (BEPS Action 11)” issued on 16 April 2015. We would like to thank you for the possibility to provide our comments that allow us to engage with you on these important issues. We focus our feedback on the most fundamental issues raised in the draft.

We appreciate the time and effort invested in improving the availability and analysis of data on Base Erosion and Profit Shifting (BEPS) to help facilitate proper monitoring of the implementation of the Action Plan. However, it would have been highly desirable if there had been an appropriate analysis of the magnitudes involved prior to the discussions and proposals being presented within this project.

We conclude that the Draft provides needed clarity on the definition of BEPS and therefore gives guidance on which situations should and should not be targeted. The focus of BEPS should be on artificial arrangements to exploit the differences in countries tax rates and/or tax policy instruments. This also means that the use of such instruments in and of itself cannot and should not be classified as BEPS, nor should BEPS countermeasures be applicable to these situations.

Therefore, we urge governments to reassess whether each Action Item individually and all Action Items collectively are adequately targeted and do not have unintended spill-over effects regarding genuine economic activities.

We agree with the Draft that one of the key challenges with available data sources is that it is difficult to disentangle real economic effects from the effects of BEPS related behaviour. Estimating the effects of

* BDI (Federation of German Industries) is the umbrella organization of German industry and industry-related service providers. It speaks on behalf of 36 sector associations and represents over 100,000 large, medium-sized and small enterprises with more than eight million employees. A third of German gross domestic product (GDP) is generated by German industry and industry-related service.
BEPS requires a need to establish a counterfactual; i.e. what the outcome would have been without BEPS. There is a need to exclude the effects of real economic activities across countries independent of taxes as well as the effects of real economic activity across countries by differences in non-BEPS-affected tax rates (a change in the effective tax rate in the country/countries, introduction of investment incentives etc.). This also means that there is a need to distinguish normal tax planning from aggressive tax planning and tax avoidance.

As stated in the Draft, macroeconomic aggregates, such as foreign direct investment (FDI) include both real and BEPS related investment and returns, which are difficult or impossible to separate. It is also impossible to isolate BEPS related changes e.g. in the financing structure from non BEPS related changes. Changes in tax rates will inevitably affect the financing mix and leverage of a business. Businesses will use more debt financing if the corporate tax rate is higher and more equity financing if the corporate tax rate is lower. We note that this is not a BEPS issue as the financing mix is also influenced by government changes in investment incentive schemes and changes in regulations of financial markets and banks.

Despite the recognition that it is impossible to separate BEPS related changes from other changes, the Draft ambitiously attempts to do precisely that. We nevertheless appreciate the OECD’s recognition of the difficulties and agree with the need to try to quantify BEPS.

However, it must be ensured that the analysis of BEPS does not increase the administrative burden of businesses. It is vital that tax rules and reporting for tax purposes do not become an obstacle to trade and cross-border investment which would hamper economic growth.

Besides collecting and assessing data on the impact of BEPS measures and counter-measures, the focus of the ongoing work must continue to also be put on finding effective ways of diminishing the scale of existing double taxation. We believe that the promotion of cross-border trade and investment and the mitigation of double taxation should remain central to the OECD’s work.

Please do not hesitate to contact us if you have any questions.

Sincerely,

Berthold Welling Dr. Karoline Kampermann
Dear David,

BIAC thanks the OECD for the opportunity to provide comments on its Discussion Draft on Action 11 (Improving the Analysis of BEPS) of the Base Erosion and Profit Shifting Action Plan issued 16 April 2015 (the “Discussion Draft”).

In the attached document, you will find a number of both general and specific comments, setting out our feedback and concerns in response to the Discussion Draft. First, we acknowledge and welcome the fact that you have taken considerable care to try to distinguish the effects of real economic activity from the effects of BEPS-related activity. We welcome the balanced way in which you have interpreted the data, which gives us confidence that your subsequent analysis of the effects of implemented BEPS recommendations will be useful. Second, as you will see, we do have questions about the possible indicators listed in the Discussion Draft. In our view, some do not seem appropriate conceptually. In other cases, however, modifications might be possible, and we would be happy to discuss those latter ones further at the public consultation and beyond.

We very much hope that you find our comments useful, and we look forward to working with you on these important issues over the next few months.

Sincerely,

Will Morris
Chair, BIAC Tax Committee
1. BIAC welcomes the opportunity to give comments on this very important subject. Policy responses should always be proportionate to the issues at hand. It is therefore important to gather facts and to analyse the consequences. The Discussion Draft is comprehensive and well balanced. The difficulties of assessing BEPS should not be underestimated. It is truly difficult to distinguish real economic effects from tax effects and BEPS-related behaviour.

2. BIAC agrees with the Discussion Draft regarding the difficulties to assess where profits arise in the complex value chains increasingly applied throughout the business community. Since the corporate profit tax is, and should be, levied on profits rather than on single production factors or sales, there is a need to assess how total profits are obtained in the value chain. Corporate behaviour is influenced not only by national tax policies but also by economic activity, the business cycle and the behaviour of investors, financiers, competitors and consumers. To assess BEPS entails separating out all these other effects. It is truly a complex task.

3. BIAC believes that paragraphs 13, 68, 101 and 102 in particular provide much needed clarity on the definition of BEPS and therefore gives guidance on which situations should and should not be targeted. The focus of BEPS should be on artificial arrangements to exploit the differences in countries tax rates and/or tax policy instruments. This also means that the use of such instruments in and of itself can and should not be classified as BEPS, nor should BEPS countermeasures be applicable to these situations. Paragraph 102 states “If economic functions, assets and risks are effectively relocated to another country to take advantage of a low rate or tax credit, this does not constitute BEPS.” As paragraph 104 further states: “By definition, BEPS behaviours involve artificial shifting of profits without changes in the location where the activities creating those profits take place”. No or low taxation is not per se a concern, but unintended double non-taxation or less than single taxation as a result of artificial profit shifting is. Thus, profits (and losses) ought to move if the functions, assets and risk are in fact relocated. We would urge the OECD to use these paragraphs as the key-stone to reassess whether each Action Point individually and all Action Points collectively are adequately targeted and do not have unintended spill-over effects regarding genuine economic activities.

4. In this respect, paragraphs 107, 108 and 176 state that corporate income taxation is a form of taxation that is the least conducive to growth, an increase of the corporate income tax burden for MNEs as a result of BEPS countermeasures should not be allowed to have adverse economic effects. In other words, BEPS countermeasures must be carefully targeted and not cause an increase of the effective tax burden regarding real economic activities. If the latter should be the case, and business is wary of the fact that the Action Points could very well go beyond artificial arrangements and also impact real economic activities, it should be recognized that the BEPS countermeasures would result in adverse economic effects. The administrative costs must also not be allowed to hamper growth and job opportunities.

5. From paragraph 181, it follows that BEPS should be handled in a revenue neutral manner, thus underlining the necessity to strike a very careful balance in designing the BEPS countermeasures to prevent throwing away the baby with the bathwater.

6. BIAC agrees that one of the key challenges with available data sources is that it is difficult to disentangle real economic effects from the effects of BEPS-related behaviours. Estimating the effects of BEPS requires a need to establish a counterfactual; i.e. what would the outcome have been without BEPS. There is a need to exclude the effects of real economic activities across countries independent of taxes as well as the effects of real economic activity across countries by differences in non-BEPS-affected tax rates (a change in the effective tax rate in the country/countries, introduction of investment incentives etc.). This also means that there is a need to distinguish normal tax planning from aggressive tax planning and tax avoidance.
7. The difficulty of disentangling normal tax planning and BEPS activities is not addressed in most of the empirical research that is referred to in paragraphs 150, 151 and 152. There is no conclusive proof of artificial shifting of profits and/or the extent to which this occurs.

8. The Discussion Draft provides a high-level overview of the available economic analyses of the scale and impact of BEPS. Two approaches to estimate the scale of BEPS are proposed, the aggregate tax rate differential approach and the BEPS channels approach. The latter approach would assess BEPS from each channel (action point) while the former would try to estimate a hypothetical situation without any BEPS.

9. The BEPS channel approach appears to insufficiently recognize the fact that this approach would be based on so many variables that it would be very difficult to reach a well-founded conclusion. This is exacerbated by the fact that there at this time is no reliable data available on firm level.

10. BIAC agrees with the assessment in the Discussion Draft that neither method has a definite clear advantage. However, it does not mean that multiple approaches necessarily should be used. It is important to keep in mind the data requirements and the costs for businesses of having to submit more and more information. In this regard, we note that Paragraphs 27-29 identify the need for governments to have access to more extensive firm-level data. Although firm-level data may indeed provide more in-depth insights in some ways, it will be important to balance the additional cost to business of providing such data with the expected benefit. In addition, to the degree that more extensive information is demanded and used for analytical purposes, BIAC believes it is very important to ensure that robust and reliable mechanisms exist to ensure taxpayer confidentiality is respected.

11. Both approaches would call for a need to separate real economic factors and tax policy measures from BEPS. This task seems almost impossible. Difficulties may be reduced somewhat given that BEPS is likely to be limited to a small fraction of MNEs and may be concentrated to only some countries. Nevertheless, it is important to isolate the effect of real economic activity variables and the effect of changes in the effective tax rates in countries from BEPS-related activities. As stated in the Discussion Draft, extrapolation from a few observations and a non-random sample should be avoided.

12. BIAC strongly supports the view expressed in the Discussion Draft (par 68) that “Indicators should distinguish between BEPS and real economic effects of current-law corporate income tax features. Indicators should focus on tax shifting due to BEPS, not real economic responses to tax rate differences that reflect the impact of current-law provisions adopted by legislators, including incentives to expand business operations in their country. Legislated or discretionary tax incentives can have an important impact on reported corporate income tax payments that reflect the location of real economic activity. The challenge in developing indicators is distinguishing between the economic effects and BEPS.”

13. BIAC also agrees with the view in the Discussion Draft (par 74) that “The data used to measure most of the indicators discussed in this paper unavoidably mix the influence of real economic activities, corporate income tax policies adopted to encourage business development, and BEPS.”

14. Regarding the questions on page 19:

- Are there any additional criteria that should be used in assessing data for analysis of BEPS?
- Are there other data sources not described in this chapter that would add significantly to the analysis of BEPS? If yes, what are these data sources? Are these data currently collected, is their coverage comprehensive and, if data covers more than one country, is the data representative across the countries? Are they available for analysis, and if so, who can access them?
Do you believe existing data is sufficient to perform reliable analyses of BEPS and countermeasures? If yes, why? If no, what data is needed to undertake a comprehensive analysis of BEPS and countermeasures?

Are there other “best practices” that governments could feasibly institute to improve coverage and/or access to existing data?

15. BIAC is not aware of other data sources readily available to distinguish BEPS-related activities from other sources impacting business decisions. BIAC however, believes that purely national tax policies affecting real economic activity through changes in non-BEPS-affected tax rates may very well influence BEPS-related activities. If a government imposes punitive tariffs or taxes, businesses may try to circumvent such rules by BEPS-related measures. Confiscation of previously allowed allocations may drastically change corporate behaviour and some business measures may be heavily tax induced. Even though they are not artificial in nature they may be viewed by tax authorities nevertheless as artificial and part of aggressive tax planning. The Discussion Draft does not appear to attempt to assess the impact of any such changes in national tax policies.

16. BIAC is of the view that indicators developed in the Discussion Draft suffer from so many deficiencies that presented information is not sufficient to analyse BEPS. Many of the indicators suffer from being difficult to assess since the countries included vary from one indicator to another and over time. It could be desirable to try to have the same countries included in various analyses.

17. The list of questions on page 48 is very much in the direction of fine tuning indicators which the Discussion Draft already express have severe difficulties in isolating BEPS-related activities from other factors.

18. The questions are:

- For indicators that use a specific group of countries (e.g., top 15 countries) or different groups of firms (e.g., global top 250 companies), how should changes over time in the composition of the groups be handled? While maintaining the same composition over time ensures year-by-year comparability, annual changes in the composition would result in a more representative measure of the current value of an indicator.

- How could information about the distribution of observations used in calculating an indicator be provided as part of any analysis?

- How should the results be reported? Depending upon data availability, the indicator values may be reported globally, by country, by industry or other categories.

- Should any of the included indicators be dropped? What additional potential indicators could be included?

- The indicators based on consolidated and unconsolidated tax and financial data have been calculated using the data as reported. This includes, in some cases, using negative values for reported net income and tax expense. It also means that “outliers” are being used in the calculations.
  - Is this a reasonable approach in dealing with the limitations of reported data?
  - Are there suggestions on systematic ways to deal with extreme outliers?
Should affiliates reporting financial statement losses be included or excluded? If included, how should negative values be handled?

- Will the suggested set of indicators when considered together provide sufficient information for a strong indication of BEPS? If not, what indicators should be added or modified?

19. BIAC would like to give the following comments on respective Indicator. We broadly agree with the caveats presented under each indicator. We value the openness and frank presentation of the indicators.

20. It should be clear that none of the indicators in and of themselves give conclusive evidence, but they can be useful to provide for a rudimentary risk assessment that could result in closer examination or to provide an opportunity to MNEs to give a satisfactory explanation that there is no BEPS concern.

21. The development of indicators should not lead to additional reporting requirements for MNEs, and the design of the indicators should be reliant as much as possible on currently available information and/or additional information that will be available to tax authorities through other Action Points. The question on page 48 (paragraph 96) should therefore be answered in the negative.

22. The information need not (all) be available publicly, it is sufficient that tax authorities can conduct the risk assessment. Confidentiality of proprietary information should be safeguarded.

23. In addition, insofar the indicators should lead to closer examination and/or additional information requests, the tax authorities should address these to the global headquarters rather than engaging the MNE at a local level.

**Indicator 1: The concentration of foreign direct investment to GDP.**

24. BIAC questions whether it is appropriate to mix stock and flow variables. When markets open up, the GDP of the region or country may be low and large FDI inflows should not be taken as a BEPS-indication. It is also wrong to implicitly make a value judgment on the tax policy undertaken by a sovereign state imposing a below average corporate tax rate.

25. This approach could put all FDI in a single country in a negative light, regardless if the FDI represents genuine economic activities. The indicator is likely to capture only a small portion of all FDIs and some smaller countries may question whether this is appropriate. BIAC sees few merits for this indicator as presented.

**Indicator 2: High profit rates of low-taxed affiliates of top global MNEs**

26. Profitability may vary from market to market irrespective of the ETR. Assets should not be the only measure of economic activity used, in particular if they have not been adjusted for functions and risks. Furthermore, the tax variable does not reflect actual taxes or tax liability on current-year income. Moreover, real economic activity variables and tax rules may influence the results rather than BEPS-related activities.

27. The assets summed up in paragraph 90 are more or less limited to the brick-and-mortar economy and might therefore not give a fair measure of economic activity. Even though there is no separate digital economy, it is clear that these types of activities are pervasive in all sectors of the economy. Also other intangible assets or activities would not be taken into account. By doing so, there could be a question how sustainable such an indicator would be in the longer run. It should therefore be clear that certain functions and risks (as described in the Transfer Pricing Guidelines for MNEs and Tax Administrations) also
constitute genuine economic activities and should therefore not be discarded in the corresponding indicators.

28. For indicator 2, there is a need to distinguish between the profit rate and profit level, and the level of taxation from ETR. With this measure, it will not be possible to distinguish the legitimate utilisation of tax incentives from real BEPS activities. Firm characteristics and the countries which are included must be controlled for.

**Indicator 3: High profit rates of MNE affiliates in lower-tax locations**

29. The analysis has not controlled for the fact that mature economies may have higher corporate tax rates and higher capital intensity. Since risks are typically greater in developing countries, profits also need to be greater on average. The fact that production in less developed countries tends to be more labour intensive may increase profits relative to assets. The same caveats as for indicator 2 applies.

30. There should also be room to compensate for the extent that certain economic activities are high value adding and others are low value adding. It would make sense if the indicator could flag low levels of profit connected to high value adding activities and the other way around. Otherwise, there is a danger that this indicator would only flag normal tax handling instead of BEPS concerns.

**Indicator 4: Profit rates compared to effective tax rates for MNE domestic and foreign operations**

31. The plot in figure 2.3 shows a very dispersed outcome. Many businesses experience different profitability due to the need for market penetration or other economic circumstances. BIAC agrees with the caveats presented in the Discussion Draft. The variation in the numbers presented in Table 2.3 and in Figure 2.3 would call for serious concerns using this indicator. As for the other indicators presented, the lack of credible explanation of underlying changes from year to year or from country aggregate to other country aggregates is striking. Which BEPS-related activities would explain such variation in the results?

**Indicator 5: Effective tax rates of MNEs compared to comparable domestic firms**

32. It will be hard to find domestic comparable companies, especially in small open economies. The nature of activities undertaken by MNEs and the income they earn tends to differ to domestic firms. Because of globalization and falling transactions costs, an increasing number of firms are established in more than one country. This is also often the case for firms servicing only the domestic market since they are frequently subsidiaries to MNEs in other countries. There are often specific circumstances for companies to refrain from engaging in competition in foreign markets. Such characteristics distinguish these businesses from other businesses and it obviously also impairs the possibilities to make appropriate comparisons with MNEs. The tax treatment of outbound versus inbound investment, interaction with tax treaties and interactions with domestic tax systems (dividend imputation rules, incentive schemes etc.) may lead to differences in effective tax rates and must be controlled for as well as for genuine commercial activities. It seems that comparisons would lead to very skewed results.

**Indicator 6: Royalties received compared to R&D spending**

33. Research and development include current plus capital expenditures on both public and private R&D activities performed within a country. Royalty receipts are payments for the use of intellectual property that may not be directly related to the measure of R&D spending. The countries included vary and the time lag between royalties received and R&D spending is not dealt with in a satisfactory way.
34. This metric appears not to capture the possibility that IP is transferred across borders for non-BEPS business reasons. Sales of IP at fair market value would not give rise to BEPS, but would inflate the proposed metric.

35. The indicator seems to be sensitive to changes in R&D expenditures, which vary between countries and over time for economic reasons. If R&D expenditures fall rapidly during an economic crisis affecting a limited number of countries more than others, the indicator might increase regardless of any BEPS-activities, at least as long as royalty payments are less volatile. BIAC has serious doubts about the validity of this indicator.

**Indicator 7: Interest expense to income ratios of MNE affiliates in countries with above average statutory tax rates**

36. The measure included is not net-interest payments. This is a major and unacceptable deficiency. Furthermore, the effect of the corporate tax rate level on leverage seems not to be controlled for.

37. It stands to reason that the indicator regarding interest deduction has to be in alignment with the outcomes of Action Point 2 and 4. It makes no sense if the interest-to-income ratio under the Earning Stripping Rule could be 1.3:1 (net interest payment!) but that the same or smaller ratio would put up a red flag under this indicator.

38. Questions on page 74.

- Are there any alternatives to the two approaches (aggregate tax rate differential and BEPS channels) for measuring the scale of BEPS?
- Are there recommended approaches for extrapolating from studies based on a non-random sample of MNEs, from individual countries or limited countries, to a global estimate?
- Are there other important empirical studies about the scale or economic impact of BEPS and/or the Action Items which are not included in the reference listing?
- Are there additional empirical studies about the effects of BEPS in developing economies? What would an ideal economic analysis of the scale of BEPS include – data, dependent variable, tax variable, independent variables?
- Are there other analyses of BEPS that governments’ tax administrations or tax policy office might consider with currently available data?
- Would internationally-coordinated BEPS countermeasures increase or reduce taxpayer compliance costs relative to your expectation of future country tax rules in a world without the BEPS project, and what would be the key determining factors?
- Are there studies of the cost of compliance with international tax rules, and do any of them estimate the cost of complying with non-internationally coordinated tax rules?
- Are there any studies that estimate the costs of MNE international tax planning?
- Are there additional empirical studies on the competition issue between companies and on the competition (spill-overs) issue between countries?
• Are there empirical studies that analyse whether reductions in ETRs from BEPS behaviours have different economic effects (e.g., efficiency, incidence, welfare) from general reductions in ETRs from legislated policy changes?

39. BIAC strongly advises against extrapolating. It is important to present credible assessment of BEPs and measures conducive to assessing the effects of policy actions taken. The risk of increased international double taxation must be handled in a decisive and appropriate manner. All increases in administrative costs will lead to decreases in investment and employment levels so it is necessary to minimize such increases for this Action point, as well. Since several of the measures may result in policy changes in excess of what is called for to address BEPS, any developed methodology to measure BEPS should also be able to assess the likely real reallocation of resources, investment and job opportunities between countries that follow due to enacted legislative changes due to the Action points in BEPS. If a business is assessed higher income in a country due to tax rule changes, there will be an incentive to relocate production and costs to that country as well. Such a development may have serious tax revenue consequences for individual countries.

40. When reading paragraph 179, it is interesting to note that the OECD appears to give some argumentation against there being an apparent race to the bottom. In fact, CIT revenues have been rather stable relative to GDP.

41. There is a need to develop best practice in the government sector and to evaluate indicators and measures presented over time of BEPS. BIAC stands ready to give input in this process of im
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.

This paper has been prepared by Francis Weyzig, with comments and input from Alex Cobham, Veronica Grondona and Sol Picciotto.

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 disproportionately 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 intermediates 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 indicators 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.

Through its members, BUSINESSEUROPE represents 20 million European small, medium and large companies. BUSINESSEUROPE’s members are 41 leading industrial and employers’ federations from 35 European countries, working together since 1958 to achieve growth and competitiveness in Europe.

BUSINESSEUROPE is pleased to provide comments prepared by the members of its Tax Policy Group, chaired by Krister Andersson, on the OECD Discussion Draft entitled “BEPS Action 11: Improving the Analysis of BEPS” 16 April 2015 – 8 May 2015 (hereinafter referred to as the Draft).
General comments

BUSINESSEUROPE welcomes the opportunity to give comments on this very important subject. Unfortunately, different numbers on the size of BEPS, unfounded in proper estimates, have been floating around in media for quite some years. Even a highly reputable institution like the European Commission has on its website unfounded estimates of a loss at up to 1 trillion euros a year. It is therefore exceptionally refreshing and important to read the Draft, stating the methodological difficulties in assessing the size of BEPS. Obviously, policy responses should be proportionate to the issues at hand and it is therefore necessary to analyse the real dimension of BEPS.

BUSINESSEUROPE finds the Draft comprehensive and well balanced. The difficulties of assessing BEPS should not be underestimated. It is truly difficult to distinguish real economic effects from tax effects and from BEPS-related behaviour.

BUSINESSEUROPE agrees that one of the key challenges with available data sources is that it is difficult to disentangle real economic effects from the effects of BEPS-related behaviours. Estimating the effects of BEPS requires a need to establish a counterfactual; i.e. what the outcome would have been without BEPS. There is a need to exclude the effects of real economic activities across countries independent of taxes as well as the effects of real economic activity across countries by differences in non-BEPS-affected tax rates (a change in the effective tax rate in the country/countries, introduction of investment incentives etc.). In paragraph 102 of the Draft it is stated that “If economic functions, assets and risks are effectively relocated to another country to take advantage of a low rate or tax credit, this does not constitute BEPS.” This means that there is a need to distinguish corporate business decisions taken due to the tax system from BEPS-activities.

The Draft states, in paragraph 68, that “Indicators should distinguish between BEPS and real economic effects of current-law corporate income tax features. Indicators should focus on tax shifting due to BEPS, not real economic responses to tax rate differences that reflect the impact of current-law provisions adopted by legislators, including incentives to expand business operations in their country. Legislated or discretionary tax incentives can have an important impact on reported corporate income tax payments that reflect the location of real economic activity. The challenge in developing indicators is distinguishing between the economic effects and BEPS.”

The Draft also states, in paragraph 74, that “The data used to measure most of the indicators discussed in this paper unavoidably mix the influence of real economic activities, corporate income tax policies adopted to encourage business development, and BEPS.”

BUSINESSEUROPE agrees with the Draft regarding the difficulties to assess where profits arise in the complex value chains increasingly applied throughout the business community and the influence that real economic factors and national tax policies have on economic activities.

BUSINESSEUROPE concludes that the Draft provides much needed clarity on the definition of BEPS and therefore gives guidance on which situations should and should not be targeted. The focus of BEPS should be on artificial arrangements to exploit the differences in countries tax rates and/or tax policy instruments. This also means that the use of such instruments in and of itself can’t and shouldn’t be classified as BEPS, nor should BEPS countermeasures be applicable to these situations.

BUSINESSEUROPE would urge governments to reassess whether each Action Point individually and all Action Points collectively are adequately targeted and do not have unintended spill-over effects regarding genuine economic activities.
The Draft provides a high-level overview of the available economic analyses of the scale and impact of BEPS. Two approaches to estimate the scale of BEPS are proposed: the aggregate tax rate differential approach and the BEPS channels approach. The latter approach would assess BEPS from each channel (action point) while the former would try to estimate a hypothetical situation without any BEPS.

The BEPS channel approach appears to insufficiently recognize the fact that this approach would be based on so many variables that it would be very difficult to reach a well-founded conclusion. This is exacerbated by the fact that currently there is no reliable data available on firm level.

BUSINESSEUROPE agrees with the assessment in the Draft that neither method has a definite clear advantage. However, it does not mean that multiple approaches necessarily should be used. It is important to keep in mind the data requirements and the costs associated with it for businesses when having to submit more and more information. BUSINESSEUROPE would like to stress the need to keep administrative costs to a minimum and that it is necessary to respect taxpayer confidentiality regarding business sensitive information.

Both approaches would call for a need to separate real economic factors and tax policy measures from BEPS. This task seems almost impossible. Difficulties may be reduced somewhat given that BEPS is likely to be limited to a small fraction of MNEs and may be concentrated to only some countries. Nevertheless, it is important to isolate the effect of real economic activity variables and the effect of changes in the effective tax rates in countries from BEPS-related activities. As stated in the Draft, extrapolation from a few observations and a non-random sample should be avoided.

BUSINESSEUROPE is not aware of other data sources readily available to distinguish BEPS-related activities from other sources impacting business decisions. It would have been valuable if Member States in the EU in particular, could have reported their best practices for assessing BEPS and if the OECD and the European Commission could assess and compile such information.

BUSINESSEUROPE believes that purely national tax policies affecting real economic activity through changes in non-BEPS-affected tax rates may very well influence BEPS-related activities. One such area is arbitrary rules for consolidation and loss-offsets, violating the principle of net taxation of profits. Since the corporate tax is levied at discrete intervals (often yearly assessments) rather than continuously (day by day or second by second), the tax due on a given profit stream may be affected. The arbitrary assessment time intervals often result in violations of the principle of net taxation and the effect of the assessment period is not always properly recognized. The efforts of companies to ensure effective taxation of the net profit stream over time has even been the focus of studies at the OECD implying that it would be inappropriate corporate behaviour (see e.g. the OECD booklet “Corporate Loss Utilisation through Aggressive Tax Planning”). Even though the corporate actions are not artificial in nature they obviously may be viewed by tax authorities as artificial and part of aggressive tax planning and probably considered as BEPS. The Draft does not appear to address this issue or to assess the impact of any such changes in national tax policies.

BUSINESSEUROPE is of the view that indicators developed in the Draft suffer from so many deficiencies that the presented information is not sufficient to analyse BEPS. Many of the indicators are too difficult to assess since the countries included vary from one indicator to another and over time. It could be desirable to try to have the same countries included in various analysis.

BUSINESSEUROPE agrees with the comments presented by BIAC on each of the Indicators and would like to underline the concerns expressed by BIAC and ICC regarding indicators 1 and 6. It should be clear that none of the indicators in and of themselves give conclusive evidence, but they can be useful to provide for a rudimentary risk assessment that could result in closer examination or to provide an opportunity to MNEs to give a satisfactory explanation that there is no BEPS concern.
The development of indicators should not lead to additional reporting requirements for MNEs, and the design of the indicators should be reliant as much as possible on currently available information and/or additional information that will be available to tax authorities through other Action Points. The information doesn’t need to be (all) available publicly, it is sufficient that tax authorities can conduct the risk assessment. Confidentiality of proprietary information should be safeguarded.

In addition, insofar the indicators should lead to closer examination and/or additional information requests, the tax authorities should address these to the global headquarters rather than engaging the MNE at a local level.

BUSINESSEUROPE strongly advises against extrapolating. It is important to present credible assessment of BEPS and measures conducive to assessing the effects of policy actions taken. The risk of increased international double taxation must be handled in a decisive and appropriate manner. All increases in administrative costs will lead to decreases in investment and employment levels so it is necessary to minimize such increases for this Action point, as well. Since several of the measures may result in policy changes in excess of what is called for to address BEPS, any developed methodology to measure BEPS should also be able to assess the likely real reallocation of resources, investment and job opportunities between countries that follow due to enacted legislative changes due to the Action points in BEPS. If a business is assessed higher income in a country due to tax rule changes, there will be an incentive to relocate production and costs to that country as well. Such a development may have serious tax revenue consequences for individual countries, in particular in a number of smaller European countries with extensive outbound investment activities in the past.

BUSINESSEUROPE would be willing to engage in a constructive dialogue with the OECD and the European Commission on improving the analysis of BEPS.

On behalf of the BUSINESSEUROPE Tax Policy Group

Yours sincerely,

James Watson
Director Economics Department
CBI RESPONSE TO THE OECD PUBLIC DISCUSSION DRAFT ON BEPS ACTION 11: IMPROVING THE ANALYSIS OF BEPS

1. The CBI is pleased to comment on the OECD’s Public Discussion Draft on Action 11: Improving the Analysis of BEPS.

2. As the UK’s leading business organisation, the CBI speaks for some 190,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

3. The CBI continues to support the BEPS programme to update international tax rules to reflect modern business practice, tackle abusive tax structures and target the incidence of double non-taxation. However, we are concerned that if complexity and uncertainty are not avoided, the outcome will be an increase of double taxation and resulting legal disputes, which could have a substantial and negative impact on cross border trade and investment, but also on tax administrations with limited resources.

4. We have reviewed the response prepared by BIAC in respect of this paper and agree with the key points and conclusions submitted in that response. Our paper below provides an overview of the keys areas of interest for British business.

5. Action 11 should be a critical Action to legitimise the work undertaken in the BEPS project. Whilst the existence of BEPS is not in doubt, being able to specify the size of BEPS, and being able to quantify BEPS, overall, by country and by BEPS Action would provide a legitimate measure as to whether the BEPS solutions being proposed are proportionate.

6. The discussion draft is well balanced and comprehensive. As outlined in the discussion draft, it is a critical challenge to be able to disentangle BEPS related behaviours from real economic effects. Corporate behaviour is influenced by a number of factors of which tax is just one. To estimate the effect of BEPS requires determining what an outcome would have been without BEPS. Something that is incredibly difficult, if not impossible, to do from pure empirical data currently available. For example, as highlighted in paragraph 68; legislated or discretionary tax incentives have an important impact on reported corporate income tax payments that reflect the location of real economic activity. Providing tax reliefs for certain payments could make a specific project financially viable which would otherwise not proceed. For example, whilst corporate tax receipts may be reduced on say an infrastructure project, the economic benefits to the economy concerned are likely to be significantly more than the corporate tax lost (increased GDP from improved infrastructure, income tax on employee wages paid to undertake the project, sales taxes on goods to build the project, reduction is social payments as a result of jobs created from the project etc). Should BEPS be purely measured on the reduced corporate tax, or should it be netted off against all economic benefits of the overall project on the basis that the comparator of a world without BEPS was that the project would not have proceeded in the first place?

7. The discussion draft provides much needed clarity on the definition of BEPS (for example, paragraphs 12, 68, 101, 102). As highlighted in paragraph 104, by definition, BEPS behaviours involve artificial shifting of profits without changes in the location where the activities creating
those profits takes place, and when the interaction of different tax rules leads to double non-taxation or less than single taxation.

8. We agree with the approach outlined from paragraphs 64 et seq, to determine indicators of BEPS behaviours. As each of the indicators currently presented in paragraph 77 have their individual limitations, the use of a broad range of indicators to meet the definitions in this paper should be an approach to follow.

9. BEPS should be measured on a territorial basis. This should then enable the tax policies of national Governments to be taken into account and highlight the main deficiencies in tax laws. By focusing on industries or other types of measures may fail to highlights the deficiencies that still exist in international tax laws.

10. We welcome the statement in paragraph 106, that many individual countries would be expected to raise more revenue from BEPS countermeasures with internationally-coordinated rules than with unilateral country measures. This rightly focuses on the points that coordinated rules are less likely to create future arbitrage opportunities and therefore future planning opportunities. However, it is also of benefit to business as dealing with duplicate regimes would, in most situations, create a significant amount of extra compliance burden, and also lead to more and more situations of double taxation.

11. Following the conclusion of the BEPS project, business will already be required to produce a significant amount of extra information to tax authorities (e.g. Under Action 13 – country-by-country reporting and transfer pricing master files, and Under Action 12 – mandatory disclosure of international tax schemes). These documents should provide tax authorities with significantly more information that they currently possess and therefore we would suggest that analysis is also carried out on the new information that tax authorities will have to monitor BEPS before any additional burden is created for business under this Action.

We trust that you will find the above comments helpful in understanding the potential impact of the proposals outlined in your paper. We remain committed to ensuring that each BEPS Action achieves its stated goals, whilst ensuring that genuine business arrangements are not unduly impacted to which this Action forms a key part.

We remain at your disposal should you wish to discuss the issues we have raised in this paper in more detail. Please contact rob.fontanareval@cbi.org.uk or neil.anthony@cbi.org.uk for more information.
Comments on the Public Discussion Draft  
BEPS Action 11:  
Improving the Analysis of BEPS

May 7, 2015

David Bradbury, Head, Tax Policy and Statistics Division  
OECD/CTPA  
By email: CTP.TPS@oecd.org

You will find below some general comments on the public discussion draft BEPS Action 11: Improving the Analysis of BEPS (the OECD draft) in reference to the consultation taking place from April 16, 2015 to May 8, 2015.

This document may be posted on the OECD website. Full credit goes to Robert Robillard, DRTP Consulting Inc.¹

1. Background

We have had the opportunity to review this OECD Public discussion draft in an upcoming paper.² For the purposes of this OECD consultation, we shall provide a few supplementary comments.

At the heart of the matter is the fact that “significant limitations of existing data sources mean that, at present, attempts to construct indicators or undertake an economic analysis of the scale and impact of BEPS are severely constrained and, as such, should be heavily qualified.”³ The OECD also states that it is difficult “for researchers to disentangle real economic effects from the effects of BEPS-related behaviours”.⁴

¹ Robert Robillard, Ph.D., CPA, CGA, MBA, M.Sc. Economics, is Senior Partner at DRTP Consulting Inc. He also teaches tax at Université du Québec à Montréal; 514-742-8086; robertrobillard@drtp.ca. Robert is the former Transfer Pricing Chief Economist at RBRT Transfer Pricing (RBRT Inc.) and a former Competent Authority Economist and Audit Case Manager at the Canada Revenue Agency. The opinions expressed in this document are those of the author.

² This paper will be made available on drtp website in the coming weeks.

³ See the key points in Chapter 1 of the draft.

⁴ Ibid.
2. How to Measure?

These statements of fact create substantial methodological concerns for the measurement of the alleged BEPS phenomenon. There exist significant practical shortcomings in the quest that is the measurement of the purported phenomenon termed “BEPS”.

First, Borkowski (1992) suggested on transfer pricing:

“Each decision is determined by the unique combination of environmental, international and organizational characteristics of an MNC [multinational company]. Contingency theory posts that each MNC will choose the optimal transfer price for a given situation whether domestic or international based on this singular combination of characteristics. Consequently, no one correct transfer price can be prescribed for all MNCs.”

Second, as it was indicated by Cravens and Shearon (1996):

“Clearly any research in the area of transfer pricing faces important challenges including a lack of available data and use of surrogates and proxies.”

The OECD recognizes some of these challenges in Chapter 1 of although it does not address in any way, shape or form any type of practical solution in Chapter 2 or Chapter 3 of the draft.

The “dashboard of indicators” put forward in Chapter 2 is severely inadequate. It is incapable to make any worthwhile distinction between, on the one hand, the economic and commercial motivations and, on the other hand, any potential tax motivations that may be included in any type of commercial arrangement as it pertains to any controlled transaction.

3. Measuring BEPS: a Statistical or a Political Issue?

The alleged BEPS phenomenon remains first and foremost a social phenomenon with obvious political implications. It permeates from every OECD document on the matter that it is an industrialized countries issue. The reduction of the alleged BEPS phenomenon into a quantitative problem of insufficient tax revenues is worrisome.

This emphasis on the end-result is clearly ill-advised from a public policy standpoint. As once explained by Tribe (1972) in an influential paper on the matter of measuring any social or political phenomenon:

“From many perspectives, the procedures that shape individual and social activity have significance independent of the final products they generate. Yet the traditional approach of

5 The discussion below draws upon a brief discussion included in our Ph.D. thesis on the use, misuse and abuse of statistical analysis and quantitative method in social sciences.


both moral philosophy and welfare economics has been to focus exclusively on the end results of social and institutional processes in assessing their value.\(^8\)

Clearly, this is the driving force behind the professed measurement of the alleged BEPS phenomenon. The main objective revolves around the measurement of the end-results which are expressed as alleged tax revenue losses by industrialized countries. The OECD draft focuses exclusively on this end-result.

Indeed, this deeply mistaken approach is palpable in every OECD draft, document and guidance that has been released on the BEPS initiative since its official launch on February 12, 2013.\(^9\) OECD member countries, that is, industrialized countries, claim loud and clear their purported losses of tax revenues from the alleged BEPS phenomenon.

However, it is not so much the end-result of fully legitimate international tax planning that should be of concern to OECD member countries. It is rather the logical and internal processes of tax planning that should be of interest.

Simply put: why is tax planning of interest to any business already involved in complex commercial activities? Being in business is not a simple matter after all. So why would any business bother with tax planning in the first place? Might it be that the tax burden itself is basically misguided, misallocated or misdirected?

Let us conclude by stating that, just like Don Quixote entrenched in his battles against windmills, the industrialized countries are mystical and obsessively involved in a sacred journey to fight the alleged BEPS phenomenon, as it pertains to corporate taxation.

It is clearly misguided and misdirected.

Moreover, as it is actually framed, this battle is a figment of their imagination or, at best, an expression of their egotistical self-interests.

But fortunately, both developing countries and businesses all around the world are no windmills…

Robert Robillard, Ph.D., CPA, CGA, MBA, M.Sc. Economics
Senior Partner, DRTP Consulting Inc.
Professor, Université du Québec à Montréal
514-742-8086
robertroillard@drtp.ca

May 7, 2015

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Michael C. Durst  
Comments on BEPS Action 11  

Email: mdurst@intlegal.com  
Telephone +1 240 832 0134  

May 5, 2015  

I appreciate the opportunity to offer comments on the recently released “Discussion Draft on BEPS Action 11: Improving the Analysis of BEP S.” I am submitting these comments in my personal capacity; the views expressed should not be attributed to any other person or to any firm or organization. These comments (i) offer brief observations on the importance of the OECD’s efforts to design workable indicators of progress in efforts to curtail base erosion and profit shifting, and (ii) suggest two additions to the list of suggested indicators provided in the recent Discussion Draft.

The Discussion Draft appears to be based soundly on the notion that after governments have initiated tax reforms pursuant to the recommendation of the OECD’s BEPS analyses, governments and the general public should have available understandable indicators of the extent to which countries have succeeded in reducing base erosion and profit shifting from their current levels. The importance of understandable indicators, available to the public, is underscored by the likelihood that the persistence of base erosion and profit shifting, over many decades, can be explained in part by what has amounted to a lack of transparency. The great complexity of international tax rules, compounded by the complexity of multinational business operations themselves, seems as a practical matter to have protected base erosion from public scrutiny. Only after journalists and nongovernmental organizations told the story of BEPS in ways that were understandable by people other than tax specialists did sufficient public interest arise to motivate the analysis that currently is being led by the OECD. Unless countries today put in place understandable means of evaluating progress in curtailing BEPS, the global public might lose its ability to assess political leaders’ progress in achieving international tax reform, endangering the viability of the reform process.

The OECD Discussion Draft proposes a list of seven indicators to be used in measuring the effectiveness of efforts to curtail BEPS. One of these indicators is geared toward discerning the
extent to which multinationals appear to be accumulating assets in particular countries at levels that are disproportionate to the aggregate amounts of business activity taking place in those countries. Four other suggested indicators would measure the extent to which multinational groups are succeeding in reducing their effective tax rates on income from their cross-border operations. A sixth indicator, which is designed to measure the shifting of intangibles-related profits, would compare the amounts of royalties received in particular countries to the levels of research and development expenditures incurred in those countries. A seventh indicator would measure the ratio between particular entities’ interest payments and their financial-statement earnings.

All of these indicators should provide useful indications of the extent to which multinational groups are succeeding in reducing their tax liabilities through base erosion and profit shifting, and changes in these indicators over time should provide good measures of the extent to which efforts to curtail BEPS are or are not succeeding. The Discussion Draft makes a valuable contribution in designing and recommending the adoption of these measures.

The value of the envisioned system of measurements, however, might be enhanced by adding to the Discussion Draft’s list two indicators, both of which are intended to measure the extent to which reforms of transfer pricing law and practice. The OECD’s BEPS analysis as a whole emphasizes the importance of improving current transfer pricing laws and practices if efforts to curtail base erosion are to succeed. It is important, therefore, that means be provided to measure whether the processes of transfer pricing compliance, administration and enforcement are in fact gaining in effectiveness to the extent that will be required to control base erosion.

One important means of measuring the progress of transfer pricing reform is to measure changes in the spread between the adjustments that tax administrations are proposing in their tax examinations, and the amounts that ultimately are upheld following administrative appeals and judicial resolutions. This indicator would provide a strong indication of the extent to which BEPS reforms have succeeded in rendering transfer pricing laws less subjective and therefore more predictable. In 1995, the U.S. General Accounting Office (now called the Government Accountability Office), which is an arm of the U.S. Congress, conducted a study of the effectiveness of U.S. transfer pricing rules that, among other findings, showed average reductions on the order of 75 percent between transfer pricing adjustments proposed by U.S. examiners and
the amounts of the adjustments that ultimately were upheld. 1 The data used to conduct the study were taken from the management databases of the Internal Revenue Service, and similar data should be available in any tax administration with an organized program of tax examinations. The methodology used in the 1995 study can provide a starting point for the design of an indicator for use by national governments around the world. An indicator of this kind might provide the most reliable indicator reasonably available of how effective transfer pricing reform measures have proven in operation.


As a second indicator of the effectiveness of reforms of transfer pricing administration, governments might compile and make publicly available data on the widths of the arm’s-length ranges that are contained in taxpayers’ transfer pricing reports. Around the world, transfer pricing reports contained in taxpayers’ contemporary documentation, and also in requests for Advance Pricing Agreements (APAs), typically provide “arm’s-length ranges” of data from comparables for use under an OECD transfer pricing method. Often (but not always), this arm’s-length range is determined by applying statistical measures to the data, including determination of the interquartile range (that is, the distance between the 25th and 75th percentiles of the range of observations). Because, however, of the difficulties of locating independent companies that are reasonably similar to the corporate affiliates being subjected to transfer pricing analysis, few potential comparables typically are found. The resulting arm’s-length ranges do not conform to acceptable standards of statistical analysis, and the ranges are far too wide to prove satisfactory for tax administration.


For example, a typical arm’s-length range of operating margins from comparables data, in an analysis of a distribution affiliate of a multinational group under the transitional net margin method (TNMM), might extend from a low of 1.25 percent to a high of 3.85 percent. The top of the range is therefore a bit more than 308 percent above the bottom. This is a very large range of uncertainty, but in my experience ranges this large are quite typical; spreads of less than 200 percent between the bottom and top of the arm’s-length ranges provided in transfer pricing reports are unusual. To see how untenable this kind of range is the standpoint of tax administration, consider that the range in the example above would tell a tax administration that, for a distributor
with sales of $10 million per year, the arm’s-length income can fall anywhere within a range of $125,000 to $385,000. This degree of imprecision would not be tolerated under, say, an individual income tax regime, and the fact that indeterminacy of this level is very common under transfer pricing rules makes clear the need for reform.

Tax administrations generally accumulate large numbers of taxpayer transfer pricing reports in the course of examinations and APA negotiations. Governments therefore should have in their possession the data needed to track the widths of arm’s-length ranges reported by taxpayers, and the extent to which these ranges narrow over time. The OECD should consider including an indicator of this kind in its recommendation of measurements to be used in evaluating the success of BEPS reforms.

I hope that these comments prove useful to the OECD in its important efforts to address the problem of base erosion and profit shifting.

Respectfully submitted,
Michael C. Durst
Comments on OECD Discussion Draft on BEPS Action 11: Improving the Analysis of BEPS

Dear Mr. Bradbury:

EY appreciates the opportunity to submit these comments to the OECD on the Discussion Draft on BEPS Action 11: Improving the Analysis of BEPS dated 16 May 2015.

Action 11 is a foundational component of the BEPS project. An economic analysis of the occurrence of BEPS is critical to the determination of appropriate responses. Equally critical is an economic analysis of the economic implications of any counter-measures being considered for recommendation under the other BEPS Actions. Indeed, the work with respect to Action 11 should be considered integral to the work with respect to all the other BEPS Actions.

The first and most fundamental issue that must be addressed is defining BEPS in a measurable way. Chapter 2 of the Discussion Draft points out that in order to correctly estimate the scale of BEPS, it is critical to define the “counter-factual”, which is a world without BEPS where the location of profits is aligned with the location of the economic activities that generated those profits. However, there is, conceptually, a lack of agreement in the economic literature on how to define this counter-factual. We are concerned that the lack of a better understanding of what the world would look like without BEPS necessarily limits the usefulness of the BEPS indicators and also the insightfulness of the empirical evidence that is found in the economic literature.

Chapter 2 of the Discussion Draft discusses several specific potential BEPS indicators in detail. All of these indicators suffer from this underlying uncertainty over what a world without BEPS would look like. Each of these indicators needs a defined baseline against which BEPS-related activity can be evaluated.

Indicator 1 is an indicator of concentration of foreign direct investment. It compares the ratio of net FDI stock to GDP for the top 15 countries to the same ratio for all other countries. This is a good example of
an indicator that is hard to interpret without a conceptual and empirical baseline. Businesses invest in countries for a whole range of non-tax reasons including geographic location, natural resources, sophisticated legal system, political stability, skilled workforce, labor costs, customer base, infrastructure and facilities, language, education system, etc. This ratio of FDI stock to GDP indicator will vary widely across countries due to these and other economic factors even in the absence of BEPS-related activity. Any such statistical distribution will produce extreme values at the tails. Changes in variance or skewness will alter the ratio of those extreme values to the mean. There currently is no basis on which to evaluate what value this indicator might have in the absence of BEPS-related activity. If the indicator is looking for “abnormally high” values, what value would be considered “normal”? Furthermore, this indicator’s relationship to tax policy is very indirect because there is no tax measure that is included in the indicator or used in its evaluation. Indicator 6, which is an indicator of concentration of royalty payments relative to R&D expenditures, suffers from similar issues.

Indicator 7, on interest expense to income ratios in affiliates of multinational enterprise (MNE) groups in countries with above average statutory tax rates, inappropriately mixes affiliate capital structure choices with BEPS-related activities. As a matter of basic corporate finance principles, companies will choose to finance themselves with more debt and less equity in higher tax jurisdictions in order to minimize their cost of capital. This principle applies to both wholly domestic firms and MNE affiliates. In the case of this indicator as well, it is important to establish a good counter-factual or baseline to guide interpretation of the indicator. Even in the absence of BEPS activity, companies in high statutory tax-rate countries generally will have higher interest-to-income ratios. It also is true that entities with above average interest-to-income ratios must, all else equal, account for more than half of all interest expense. Combining these two observations, it is inevitable that MNE affiliates in countries with above average statutory tax rates and with above average interest-to-income ratios will account for the largest share of interest expense. In order to use this indicator as an effective indicator of BEPS activity, it would be necessary to determine what the value of the indicator would be in the absence of BEPS.

Indicators 2-5 have, to a greater or lesser extent, similar issues as discussed above. In addition, Indicators 2-5 place a heavy reliance on the use of profit rates as a function solely of assets as measured by financial statements. Chapter 3, paragraph 123 of the Discussion Draft makes the relevant point that a properly specified production function includes numerous other factors of production in addition to assets, with many of such other factors poorly measured, or not measured at all, by company financial statements.

Economists’ theory of the multinational enterprise emphasizes the central role played by intangible assets and management services in the organization and activities of MNEs. It is the deployment of these assets across national borders that explains the role of MNEs in international trade and investment. These firm-specific assets are not easy to measure directly, but they are highly valued by market participants. It is vital to the success of the OECD’s work under Action 11 that the work be approached with the understanding that MNEs are distinct from purely domestic enterprises.

Notes:
Another fundamental component of the economic analysis of BEPS is having the data needed to apply any indicators that are developed. The Discussion Draft acknowledges that there are significant limitations on the data sources that are available currently and that any economic analyses of the scale and impact of BEPS activity would have to be heavily qualified. The Discussion Draft further suggests that more comprehensive and more detailed data regarding MNEs is needed. In this regard, we would underscore the additional reporting that will be required of MNEs under other elements of the BEPS Action Plan, particularly Action 13. The country-by-country report will require that MNEs gather information of a type and in a manner that it are not required for any other accounting or tax purpose. The master file/local file framework for transfer pricing documentation will require extensive quantitative and qualitative information about the MNE group and about the individual entities in the group. We would urge that the OECD look first to the data that will be collected through this new information reporting before considering any new reporting requirements. At the same time, we urge that the limitations of the country-by-country reporting information be carefully considered if such information is to be used for any purpose other than the high-level risk assessment for which it was specifically intended.

In addition to the matters addressed in the Discussion Draft, we would urge the OECD to undertake a broader economic analysis of the implications of the recommended BEPS counter-measures. Action 11 calls for an analysis of the effectiveness and economic impact of the actions that are taken to address BEPS. That analysis should include a study of the impact of measures recommended under the various BEPS actions on global trade and investment and global welfare. We are concerned that some of the measures being developed have the potential to have impacts well beyond targeting BEPS-type activity. Some of the measures are not structured to appropriately target artificial activity and instead sweep in real economic activity that should not be attacked by the BEPS effort. Measures that interfere with real economic activity will have adverse consequences for global trade and investment and global welfare. Just as the OECD should measure the effectiveness of BEPS counter-measures, they also should measure the adverse impact of measures that go beyond targeting BEPS activity.

Moreover, in looking at the broader economic implications, the OECD should focus particular attention on elements of the economy that have gotten less attention to date. While there is much discussion of the biggest MNEs, it is important also to consider the effect of the BEPS project – and recommended BEPS measures – on smaller businesses given that with today’s technology even small businesses can be global. The burdens of new complexity arising from the BEPS project will fall on small businesses as well as large MNEs. While the OECD has focused on the implications for emerging economies, that attention has largely been from the perspective of inbound investment into those countries. Consideration also should be given to the economic implications for the growing outbound investment from emerging economies. Finally, the OECD should analyse the impact of the recommended BEPS counter-measures, particularly those that shift the balance between source and residence based taxation, on overall foreign direct investment.4


If you have questions or would like further information regarding any of the points discussed above, please contact Bob Carroll (robert.carroll@ey.com), Barbara Angus (barbara.angus@ey.com), or me, Alex Postma (alex.postma@ey.com).

Yours sincerely
On behalf of EY

Alex Postma
Submission to the OECD Public Discussion Draft
BEPS Action 11: Improving the Analysis of BEPS

Ronald B. Davies and Iulia Siedschlag

Dr Ronald B. Davies is Professor of Economics at the University College Dublin and a Research Affiliate at the ESRI. Specializing in trade and foreign direct investment, with a particular interest in government policies affecting globalization, he works in both theory and empirics. Prof. Davies has published in international journals such as *American Economic Review, American Economic Journal, International Economic Review, Journal of International Economics, Journal of Public Economics,* and *Journal of Development Economics.* He is an editor of *International Tax and Public Finance.*

Dr Iulia Siedschlag is Associate Research Professor and Head of the Centre for Internationalisation and Competitiveness at the ESRI. Her key areas of expertise include international trade and investment, economic growth, technological change and innovation in open economies. Her research has been published in international journals such as *Research Policy, Journal of Economic Integration, Open Economies Review, Kyklos, Labour Economics, Applied Economics, China Economic Review, Regional Studies, Economics of Innovation and New Technology, Journal of Economics and Statistics,* and *International Journal of Public Policy.*
This document provides general comments on the analysis of the scale and economic impact of BEPS (Section I) and a set of specific comments on individual indicators proposed by the OECD Discussion Draft BEPS Action 11: Improving the Analysis of BEPS (Section II). Section III provides responses to specific questions for consultation in relation to the proposed indicators to measure BEPS. Finally, we propose a mechanism design approach to measuring BEPS (Section IV).

I. General Comments

1. The analysis of the scale and economic impact of BEPS would benefit from a broader theory-based conceptual and methodological framework that would provide a benchmark for the interpretation of the empirical results and their implications.

2. Profit shifting by multinational firms may be linked to cross-border tax rate differentials as well as other non-tax reasons, including risk sharing, and operating of internal capital markets. In this context, it would be important to generate the counterfactual of the location of corporate profits without tax-related profit shifting.

3. The allocation of taxing rights on corporate income between countries under the current international arrangements is very challenging in the context of increased international integration of production and innovation. The competitiveness of firms depends increasingly on their intangible assets which are internationally mobile and are difficult to measure. Identifying where profits are generated is complex and difficult even conceptually. These features have implications on the robustness and interpretation of the proposed indicators to measure BEPS and empirical estimates of tax-motivated profit shifting.

II. Comments on Proposed Specific BEPS Indicators

4. As a general comment, the notion that presenting a range of indicators covers a problem in one sounds good in theory, but those proposed do not do this very well. In particular, several use "profit rates", i.e. sales/assets or the like. If this measure is problematic, which it certainly is, this will throw off multiple indicators in the same direction. Thus, the overall combination of indicators is an issue. We now detail issues specific to the individual indicators.

Indicator 1: Indicator of concentration of foreign direct investment

5. An important question to ask is what measure of foreign direct investment (FDI) to use: stocks vs. sales? Davies (2008) indicates that there is a difference in those two measures across countries, potentially reflecting differences in the sector makeup of the two with developing countries tending to have a higher stock/sales ratio (i.e. more capital intensive).

6. What about measuring FDI by employment/total employment? This too will tend to have a bias as there is a fixed employment component to a firm's operations. As such, in industries where firm operating sizes are small, these fixed aspects will have a larger role to play. Furthermore, it ignores the issue of outsourcing.

7. One key issue to consider is that, as very well documented, smaller countries will have more FDI relative to the size of the economy.
**Indicator 2: High profit rates of low-taxed affiliates of top global MNEs**

8. This indicator requires a constructed profit rate, something which is likely to suffer serious flaws. In particular, many of the factors influencing this indicator have a strong potential to bias the observed relationship between this profit rate and taxes.

9. The primary variable here is a measure of the profit rate, i.e. sales/assets. This is problematic on many fronts. First, it ignores sector variation not only across MNEs, but within a MNE. For example, consider a firm with a low-capital intensive headquarters and a high-capital intensive production affiliate. Then by definition, this will tend to inflate the profit rate in the headquarters.

10. Further, one would expect that if this indicator will be used by policy makers, that firms will begin to manipulate the determinants of it with the possibility of real economic inefficiencies (see Hines, 2010).

11. Herger and McCorriston (2014) show that up to 50% of cross-border mergers and acquisitions have no clear vertical or horizontal relationship between the target and acquiring firms. Therefore, to compare profit rates not only across sectors, but across parts of the firm that do not operate in tandem, is misleading.

12. Using something like sales as the indicator of economic activity is problematic on two fronts. First, sales will often have a strong local component. If the markets vary across countries this will affect sales and therefore the profit rate. There is an increasing body of literature indicating pricing to market activities (e.g. Bastos and Silva 2010; Manova and Zhang 2012). Second, sales will need to be large enough to cover the fixed cost of FDI (see Helpman, Melitz, and Yeaple 2004). This will introduce variation across countries/sectors/activities in the level of sales needed to make that worthwhile.

13. This measure does not account for risk. If location and activity decisions are endogenous, then one would expect that in riskier markets/activities, that the rate of return would necessarily be higher for the firm to engage in that location/activity.

14. Other possibilities such as employment and operating expenditures are also likely to be impacted by country/sector/activity variation in the productivity of workers (affecting employment and total payroll), local price levels (affecting wages and employment) and other local costs such as raw materials, utilities, and transport (affecting operating expenses).

15. Within multiproduct firms, one would expect the profit rate to vary by the extent that a given affiliates activities align with the firm's core competency (see Eckel and Neary 2010). This would thereby throw the measure off.

16. Firms use internal financing methods to influence management (see Stoughton and Talmor, 1994). This too will affect the profit rate for non-tax reasons.

**Indicator 3: High profit rates of MNE affiliates in low-tax locations**

17. First, this indicator relies on the profit rate measure, suffering from all of the above problems. Second, this instantly biases the indicator by focusing only on high profit rates in low tax locations, ignoring low profit rates in the same country and what is happening in high tax locations.

18. It is unclear how tax rates will be calculated. As effective rates will vary across firms due to their ability to utilize features of the tax system such as accelerated depreciation, R&D tax credits, and so forth, what may be a low tax country for one firm may not be so for another.
19. Furthermore, the low-tax designation is inherently comparative. Consider two firms, one in two countries with a 5% tax rate and one with an affiliate in a 5% tax rate country and another in a 25% tax rate location. In the first, should we consider that either of the affiliates are in a low-tax location? Arguably not as there is no reason for profit shifting in that case.

**Indicator 4: Profit rates compare to effective tax rates for MNE domestic and foreign operations**

20. Again, the use of profit rates suffers from numerous problems. Likewise, as above, there is no obvious way to construct effective tax rates and what is constructed will certainly be subject to firm manipulations. In particular, if different affiliates, engaged in different activities that can avail of differing tax write-offs (R&D credits for example), this will affect the comparison of affiliate ETRs even within the same firm.

21. It is unclear how one can hope to separate out domestic and foreign operations. In particular, when intangibles operate as a joint input (Markusen, 1984) even in the absence of trade, affiliates will be linked.

**Indicator 5: Effective tax rates of MNEs compared to comparable domestic firms**

22. Again, the effective tax rates (ETR) will likely vary even within a firm because of the different choices (such as investment and R&D) made by affiliates and the impact this has on their tax burden.

23. In particular, we know that multinationals are not average firms. A large body of literature shows that they do more R&D, are larger, are more productive, and are much more likely to import and export. In much of this literature (e.g. Helpman, Melitz, and Yeaple 2004), the point is that more productive firms choose to become multinationals. In this light, to compare a firm that made this choice to one that did not is to compare an innately more productive firm with a less productive one. As this difference is likely to lead to other different decisions (such as investment) it will lead to different ETRs across them. Therefore any such comparison is flawed.

**Indicator 6: Concentration of royalty payments relative to R&D expenditures**

24. R&D is inherently an uncertain activity. While presumably greater expenditures increase the likelihood of a successful, marketable innovation, there is a large degree of variance in the conversion of expenditures into sales. As such, this measure will penalize "lucky" firms that achieve a successful innovation early in the process and shelter those that do not have success. Furthermore, there is likely to be a large difference in this measure across industries (with more cutting edge industries likely requiring more expenditures to push the frontier) and across countries (as the cost of skilled labour and other inputs will vary by location).

**Indicator 7: Interest expense to income ratios of MNE affiliates in countries with above average statutory tax rates**

25. As noted above, one would expect that the rate of return would vary by risk of the investment. This also applies to internal loans, with riskier projects and locations facing higher interest rates.

26. As with Indicator 3, this presupposes that BEPS is occurring by focusing on a select set of countries.

27. Similar to the above noted issues regarding internal transactions, it must be remembered that internal interest rates are used for internal management as well as potential profit shifting.
28. A key factor in the internal interest rate is access to funds. Affiliates that can borrow in local markets cheaply may seek those funds before tapping parent funding (which has an opportunity cost to the multinational). Similarly, the lending affiliate's cost, and therefore the interest rate, will depend on their access to funding. If local capital markets are important to the firm (as indicated by Davies and Gresik 2003), then these local considerations will have an important impact on this indicator.

III: Specific Responses to Questions for Consultation

For indicators that use a specific group of countries (e.g., top 15 countries) or different groups of firms (e.g. global top 250 companies) how should changes over time in the composition of the groups be handled? While maintaining the same composition over time ensures year by year comparability, annual changes in the composition would result in a more representative measure of the current value of an indicator.

29. One would expect that, for categories such as this, the top few countries/firms will remain fairly stable over time with much more fluctuation for those near the cut-off. To make a comparison, the top five origins and destinations for FDI are fairly steady, however, the number 9 and 10 positions churn year to year among another group of countries.

30. As such, a better alternative would be to create "bands" based on countries' past average performances. For example, suppose that you consider a country's ranking for a given indicator over a moving window of the past 10 years. If it enters the top 15 more than 8 times, it is in the "high", if it enters 5-8 times, it is in the "medium" group, if it enters 2-4 times, it is in the "low" group and if it enters at most once, it is in the "not included" group. With these groups now defined, the indicator can be averaged within a group and then this can be used to construct a weighted average across the low, medium and high groups to construct a global average. Obviously, the weights will affect the global average, therefore careful consideration should be given to address the number of countries within a category and the relative importance across categories.

31. The advantage of this approach is that it will minimize fluctuation of the band a country is in year-on-year and thus minimizing the issue of the changing set of countries under consideration, yet the moving average of a 10-year window will introduce the desired time series movements.

32. Note, however, that in line with the above criticisms, that these group definitions are problematic. For example, whether one uses stocks, flows, employment, or some other measure of FDI will dramatically affect the top 15 countries in indicator 1. Likewise, focusing on only low-tax countries (where that definition itself may vary year on year) a priori allocates some countries to the "not included" group

How should the results be reported? Depending on data availability, the indicator values may be reported globally, by country, by industry or other categories.

33. This question clearly depends on the indicator in question as some (such as Indicator 1) are by definition at the country level whereas others (Indicator 4) are inherently at the firm level. This latter approach raises something not addressed: the issue of confidentiality. In particular, if indicators are to be made public, they must be aggregated so as to maintain firm confidentiality. This will inherently affect the way in which they can be reported.

34. That aside, in order to be meaningful, the indicator must be reported at a sufficiently disaggregated level so as to make a comparison possible. For example, Indicator 2 considers the profit rate of MNE affiliates in low-tax locations. What is the counter-factual? The same MNE's affiliates in a high-tax location? A non-MNE in the same low-tax jurisdiction? To judge whether the profit rate is abnormally high, an appropriate comparison needs to be made. As discussed above in Section II, this
requires a comparison of like-to-like and therefore needs to be done at the sector level. However, such a comparison may not be possible if there is no domestic activity in the sector (a problem for Indicator 5 as well) or that a given affiliate represents a unique sector in the MNE's global production chain. Thus, it is impossible to state an overarching, appropriate level of reporting across the methods and highlights the problems inherent in the measures.

**Should any of the indicators be dropped? What additional potential measures could be included?**

35. As discussed in detail above, the indicators all suffer from problems. Some (such as Indicator 1 and Indicator 3) are a priori biased because they ignore overarching data patterns and focus on a predetermined set of countries rather than treating BEPS as the global phenomenon that it is. Others, such as those relying on profit rates, suffer because of the problems inherent with imputing the key measure. Finally, indicators such as 7 and 8 will be erroneous due to the measures' inability to deal with the underlying processes driving the measure.

36. Overarching all of this is the simple fact that the extent of BEPS is private information held at the firm level. As such, attempts to obtain estimates of it will suffer from lack of data, the misrepresentation of information by firms, and changes in firm behaviour that will affect the indicator values. This suggests the need for a mechanism design, menu approach to elicit firms to self-report the extent of their BEPS behaviour. Note, however, that this will *not* stop such activities and in fact will likely reward those who do the most profit shifting. However, if the goal is to extract information to construct an accurate measure of the scale of BEPS, this is the most sound methodology. Nevertheless, this method is completely missing from the proposed approaches.

**Will the suggested set of indicators when considered together provide sufficient information for a strong indication of BEPS? If not, what indicators should be added or modified?**

37. It is our estimation that these indicators, even when taken as a whole, will not provide a measure of BEPS that is realistic or fit for purpose. As discussed in detail in Section I, the individual indicators all have significant problems. Furthermore, several rely off of the same imputed information (such as the profit rate). As such, they will all be biased in similar directions meaning that their errors will reinforce one another when "considered together", providing a false confidence an aggregated BEPS measure that is built on inaccurate assumptions. As noted above, the most theoretically sound methodology for constructing a measure of BEPS must be grounded in a mechanism design approach that elicits firms to voluntarily reveal the extent of their profit shifting. That, however, is likely to be politically difficult as it will require rewarding the firms with the most to hide, i.e. those with the most profit shifting, for providing truthful informa.

**IV: A Mechanism Design Approach to Measuring BEPS**

38. All of the proposed indicators attempt to do the same thing (albeit in flawed ways): compare the actual declaration of the tax base to what it would be in a hypothetical baseline without profit shifting. In this hypothetical, as profits are not moved for tax or other reasons, the tax base is declared where it is generated. Note that this hypothetical itself has caveats as there are other, non-tax reasons why profits might not be allocated to where they are generated. Those issues aside, the fundamental flaw in all of the proposed methods is that they are trying to construct the baseline in the presence of both firm heterogeneity and private information held by the firm. To rectify this, the most theoretically appropriate solution would be to use a mechanism design approach (building from, for example, Bond and Gresik 1996).

39. Intuitively, this approach provides firms with a schedule, or menu, to choose from with each point on the schedule corresponding to the firm revealing information about the extent of their profit
shifting in exchange for a reward. The key is to make the schedule so that firms will report truthfully, i.e. that they have no incentive to miss-state their activities because the tax that would result in would not be worth the reward from misrepresentation.

40. As a more formal discussion, suppose that the firm is defined by a “type” which includes both an \((\alpha_i)\) and two unobservable components. The first contains factors such as industry, the countries in which include the extent to which they are able to engage in aggressive tax planning. The third is a random component known only to the firm (think of this as unexpected shifts in profits). Together these make up a world-wide allocation of its profits \(\pi (\alpha_i, \delta, \varepsilon)\) which incurs a worldwide tax payment \(T(\alpha_i, \delta, \varepsilon)\). Assume that all else equal this tax payment is decreasing is \(\delta\) and that if \(\delta = 0\) the firm is not engaging in tax planning. Further, the assume that the optimal \(\delta\) is increasing in \(\varepsilon\). The baseline is then \(\pi (\alpha_i, 0, \varepsilon)\) with an associated tax payment of \(T(\alpha_i, 0, \varepsilon) > T(\alpha_i, \delta, \varepsilon)\) and \(\pi (\alpha_i, \delta, \varepsilon) - T(\alpha_i, \delta, \varepsilon) > \pi (\alpha_i, 0, \varepsilon) - T(\alpha_i, 0, \varepsilon)\).

41. The problem from the governments’ perspectives is that \(\varepsilon\) is unobservable, i.e. it cannot construct the baseline without having the firm truthfully report its random component. If the firm fears that, should it do so, that governments will take away its ability to shift profit, it has an incentive to misrepresent \(\varepsilon\). Therefore, the government would need to incentivize firms to report truthfully. By virtue of the Revelation Principle, we can restrict attention to direct mechanisms.

42. Thus, the government must provide an incentive \(\beta (\varepsilon)\) for the firm to report truthfully where the “hat” denotes the reported value. This must be so that:

\[
\pi (\alpha_i, \delta, \varepsilon) - T(\alpha_i, \delta, \varepsilon) \leq \pi (\alpha_i, 0, \varepsilon) - T(\alpha_i, 0, \varepsilon) + \beta (\varepsilon)
\]

i.e. the firm will participate, and:

\[
\pi (\alpha_i, 0, \varepsilon) - T(\alpha_i, 0, \varepsilon; \hat{\varepsilon}) + \beta (\hat{\varepsilon}) \leq \pi (\alpha_i, 0, \varepsilon) - T(\alpha_i, 0, \varepsilon; \varepsilon) + \beta (\varepsilon)
\]

i.e. the firm is better off reporting its type truthfully rather than some other type. These conditions will define the properties of the menu. With this information in hand \(T(\alpha_i, \delta, \varepsilon) - T(\alpha_i, 0, \varepsilon; \varepsilon)\) would provide a measure of the reduction in tax payments resulting from BEPS.

43. Note that this is trivially guaranteed for the lowest \(\varepsilon\), since for that type \(\delta = 0\) and there is no profit shifting. For higher type firms, this will require that they are “paid off”, i.e. a transfer must be made after profit shifting is no longer possible to elicit truth telling in the first place. This is the politically charged component as it rewards firms that were avoiding taxes.

44. Governments’ objective of ensuring that multinational firms pay a fair share of taxes on their global profits is and will remain challenging as long as at the same time governments engage in tax competition to attract foreign direct investment. While governments are justified to decide their tax policy, tax rate differentials on corporate income across countries will continue to incentivize profit shifting and thus to generate a tension between these two policy objectives. To address this tension, international cooperation and coordination of tax reforms is essential. Such tax reforms would need to consider the nature and extent of the corporate tax base as well as its allocation across countries.
REFERENCES


INSTITUTE FOR AUSTRIAN AND INTERNATIONAL TAX LAW

By email: CTP.TPS@oecd.org

May 8, 2015

Dear David,

BEPS Action 11: Improving the Analysis of BEPS

Thank you for the opportunity to comment on BEPS Action 11: Improving the Analysis of BEPS.

Executive summary

We find the draft and development of indicators to generally be intuitive and useful. The draft also correctly highlights the multiple challenges with the available data that can be used to assess BEPS. However, we find too much emphasis has been placed on the challenges and limitations relative to the potential opportunities. In our view, having several weak and appropriately caveated data-points is still highly preferable over the status quo of few uncoordinated academic assessments. As a result, we encourage the work on a "dashboard of indicators" as proposed and are looking forward to the addition of initial calculations that provide these data points for all the indicators. Lastly, we believe the review of the academic literature on BEPS could be further expanded. In particular, a critical review of the limitations in the existing literature would be an important element to underscore and substantiate concerns of insufficient signal-to-noise ratios in this work. Governments should increase their efforts in collecting the required data.

Detailed comments on specific aspects of the Discussion Draft are set out in the attached document. If you would like to discuss any of the points raised herein, please do not hesitate to contact either Jeffrey Owens (jeffrey.owens@wu.ac.at), Martin Zagler (martin.zagler@wu.ac.at), or Jan Loeprick (jan.loeprick@wu.ac.at), or Flavia Garcia (flavia.garcia@wu.ac.at). We would be happy to speak on this topic at the at the upcoming public consultation meeting.

Yours sincerely,

Jeffrey Owens
Assessment of Existing Data Sources Relevant for BEPS Analysis

We find the draft and development of indicators to generally be intuitive and useful. The draft also correctly highlights the multiple challenges with the available data that can be used to assess BEPS. However, we find too much emphasis has been placed on the challenges and limitations relative to the potential opportunities. In our view, having several weak and appropriately caveated data-points is still highly preferable over the status quo of few uncoordinated academic assessments. As a result, we encourage the work on a "dashboard of indicators" as proposed and are looking forward to the addition of initial calculations that provide these data points for all the indicators. Lastly, we believe the review of the academic literature on BEPS could be further expanded. In particular, a critical review of the limitations in the existing literature would be an important element to underscore and substantiate concerns of insufficient signal-to-noise ratios in this work. Governments should increase their efforts in collecting the required data.

Discussion of Potential BEPS Indicators

On guidelines for indicators:

Paragraphs 68-72 - Cover a wish-list of indicators which is very comprehensive but, when combining all the criteria, risks becoming unachievable. Given the need for cooperation from policy makers, in particular those of non-OECD countries, simpler indicators may be more manageable.

Paragraph 78 - Suggests tax rates influence FDI. FDI is influenced by many factors, least of all are tax differentials. In practice, the range of empirical estimates of the responsiveness of FDI to corporate tax rates is quite wide and this makes clear-cut policy recommendations difficult. Not to disregard that international competition for FDI thus reinforces the wider competitiveness arguments.

Paragraph 80 – Are indicators going to be calculated for historical trends? If yes, how far back? This seems like a worthwhile exercise. Its results would in turn also help inform the discussion on each indicator.

Paragraph 82 - We support the suggestion to explore ways of taking advantage of administrative data in a coordinated approach. We also believe that basic differentiation across industries holds a lot of promise for more accurate and relevant findings.

We would additionally recommend implementing econometric techniques to separate economic factors from profit shifting. In the simplest case, we recommend a regression based indicator that follows the standard literature in using intra-group tax differentials to assess the scale of BEPS and its drivers.  

On specific indicators proposed:

Indicator 1

As part of the results discussion it would be useful to also present the variation in the 15 top countries over time. As currently approached, keeping the same 15 countries is questionable. Moreover, the decision to select 15 countries (instead of say 5 or 20) needs to be explained. In this context, the relative importance of a few outliers should also be assessed and discussed. Additional analysis following a weighting for the actual share of each country in total global FDI could also be considered. Finally, it is difficult to justify not enumerating the countries used to establish the ratio, given that the information is public and easily accessible.

Indicator 2

When discussing the limitations of this indicator, it would be helpful to provide an overview on the data that is actually available in ORBIS. For instance, to what extend are privately-held corporations included? How does data coverage differ across OECD economies?

Indicator 4

This indicator fails to identify BEPS. Low tax jurisdictions may generate higher profits irrespective of profit shifting. This indicator risks ignoring those low tax jurisdictions may be conducive to profitability in the absence of BEPS.

Indicator 5

This particular indicator, though somewhat more complex, seems promising. It would be interesting to see illustrative results for several countries/industries.

Indicator 6

We particularly like this indicator for its relevance and elegance. A focus on intangibles is justified given that they are at the centre of many BEPS issues. It would be helpful for the understanding of the results to provide the countries in the "top" group as well as the baseline. Are all OECD economies covered in the World Bank database? However, it is important to note that this indicator is narrow and therefore especially susceptible to abuse by governmental agencies and politicians.

Economic Analysis of the Scale and Economic Impact of BEPS and Countermeasures

On Competition

Central to the discussion of BEPS is the notion of increased global competition. The existence of profits precludes the existence of imperfect competition. A conventional Amoroso Robinson Rule for Cournot Oligopoly will give:

\[ p = mc - \frac{en}{en - 1} \]

where mc are marginal costs, e is the price elasticity of demand and 1/n is the (average) share of a single firm in the market (a measure of concentration similar to a Herfindahl index). Should low tax rates be related with high competition, then an index of profit shifting based on measures of actual profits earned (or better, declared) will generate a false positive. The assertion that low tax rate be related with increased competition seems likely as low tax economies may be attractive for investors irrespective of opportunities to shift profits given the relatively greater after-tax return on investment.
On Elasticities

On page 67 elasticities are introduced in connection with two empirical profit-shifting studies. If we define tax revenues $T$ as tax rate $t$ by base $B$, $T = tB$. Then the tax elasticity is:

$$\frac{dT}{dt} = \frac{t}{T} \cdot \frac{s - 1}{s}$$

where $s$ is the elasticity of the tax base with respect to changes in the tax rate. These elasticities may vary according to the position of the economy (i.e. the tax rate) and may differ between economies, so that indicators of BEPS may over- or understate the issue, leading to false negatives. (False positives are less likely in this case.) It is typically assumed, in closed economies at least, that profits are independent of tax rates as long as $t < 100\%$. However, ceteris paribus, MNEs will move their highest yielding assets and personnel to jurisdictions with the lowest tax rates, thus altering the tax base in accordance with the tax rate (which in this case does not constitute profit).

On Differences

As noted earlier, the existence of profits precludes the existence of imperfect competition. Moreover, if profit shifting is not free of costs, and if these costs depend on factors such as the level of profits or the profit margin, then the optimal [maximizing “true” profits] pricing rule will differ from the conventional Amoroso-Robinson rule [mark up over marginal costs] and more importantly, will differ according to different market conditions. Notable market conditions vary widely, prominent examples being: price elasticity, degree of competition, differing accounting standards, and tax rates. Most measures of profit shifting, (in particular those measuring one line item as a ratio of aggregate firm profits, e.g. Sales/Profit) may find spurious correlations between low tax rates and high profits if the tax rate enters the pricing decision. The measure of BEPS will thus be contaminated by national differences relating to competition, the level of the tax rate, and accounting standards. Such indicators may make it especially difficult to distinguish news from noise.

On Buiter’s Fallacy

We find it important to note that any indicator is susceptible to contamination once adopted by politicians. Measures of BEPS are therefore certainly susceptible to misuse and manipulation by governments. Inventive governments will look into constructing loopholes that circumvent BEPS indicator(s) in an attempt to attract a greater tax base. Governments may even vet provisions on the basis of their ability to circumvent BEPS indicators. Therefore, we support the continuous use of several, broad indicators rather than fewer, narrow (albeit more elegant) indicators.

Miscellaneous Comments

Paragraph 89 - Low tax jurisdictions may generate higher profits irrespective of profit shifting. Using domestic firms as a control may not be the solution. An extension of the Melitz trade model shows that only the most productive firms will actually expand internationally; thus making it a challenge to identify wholly domestic counterparts.

Paragraph 91 - There may be a correlation between high profits and low tax jurisdictions, but this does not necessarily imply causality (see comment On Elasticities above).

In Response to Questions for Consultation

- Changes in the composition of the firm/country/etc. sample should be reflected in the indicator. Moreover, the composition of the “top” country group, as well as year-to-year changes, should be disclosed in the report.

- Results should be reported for all three categories: Global, by country, and by sector/industry.
• At this stage, with several of the indicators still in the basic construction stage, there is little harm in keeping all indicators.


• We would also propose the use of case study analysis. Revelations stemming from headline controversies such as Starbucks-UK, or Luxembourg Tax Leaks may point to more BEPS detection devices than aggregate or micro dataset analysis.

• Data should be meticulously cleaned for poor/erroneous information (such as negative entries for fixed assets or turnover) and a detailed sensitivity analysis/discussion of outlier effects added to each indicator.
VIA E-MAIL

Mr. David Bradbury  
Head of the Tax Policy and Statistics Division  
Centre for Tax Policy and Administration  
Organisation for Economic Co-operation and Development  
2, rue André-Pascal  
75016 Paris  
France  
CTP.TPS@oecd.org

Re: Comments on Discussion Draft on Action 11: Improving the Analysis of BEPS

Dear Mr. Bradbury:

This letter is submitted on behalf of the International Alliance for Principled Taxation (IAPT or Alliance) in response to the OECD’s request for input on the April 16, 2015 Discussion Draft on BEPS Action 11, Improving the Analysis of BEPS.

The IAPT is a group of major multinational corporations based throughout the world, and representing business sectors as diverse as consumer products, media, telecommunications, oilfield services, transportation, computer technology, energy, pharmaceuticals, beverages, software, IT systems, publishing, and electronics. The group’s purpose is to promote the development and application of international tax rules and policies based on principles designed to prevent double taxation and to provide predictable treatment to businesses operating internationally.

The Alliance appreciates the opportunity to be able to provide input to the OECD on this Action Item. Our comments are set forth in the Annex to this letter.

1. The current membership of the IAPT is made up of the following companies: Adobe Systems, Inc.; Anheuser-Busch InBev NV/SA; A.P. Møller-Maersk A/S; AstraZeneca plc; Baker Hughes, Inc.; Chevron Corporation; Cisco Systems, Inc.; The Coca-Cola Company; Exxon Mobil Corporation; Hewlett-Packard Company; Johnson Controls, Inc.; Juniper Networks, Inc.;
Microsoft Corporation; Procter & Gamble Co.; REXL Group plc; Repsol S.A.; TE Connectivity Ltd.; Thomson Reuters Corporation; Transocean Ltd.; Tupperware Brands Corporation; and Vodafone Group plc.

We look forward to the opportunity to provide further input as the work of Working Party 2 on Action 11 continues.

Sincerely yours on behalf of the Alliance,

Mary C. Bennett
Baker & McKenzie LLP
Counsel to the Alliance

Thomas S. Respess III, Ph.D.
Principal Economist
Baker & McKenzie Consulting LLC
IAPT Comments in Response to April 16, 2015 Discussion Draft on Action 11: Improving the Analysis of BEPS

I. Executive Summary

1. We recognize the substantial work and thoughtful commentary reflected in the Discussion Draft (“Draft”) related to Action 11. We also respect and appreciate the candor reflected in the Draft regarding the challenges faced by the OECD in attempting to measure the scale and economic impact of BEPS and proposed countermeasures. We respectfully offer our comments below relating to the status of the work under Action 11 and the conclusions and proposals outlined in the Draft.

2. While the Draft provides a thorough evaluation of data sources and tools to be used to assess the scale and economic impact of BEPS and its countermeasures, the Draft does not provide an assessment of the risk of the potential adverse consequences to trade and business investment in both developed and developing countries from the adoption of specific BEPS countermeasures. We remain concerned that any BEPS countermeasures may adversely impact global trade and business investment, and the allocation of such trade and investment across countries, as a collateral consequence. We believe the Action 11 plan is broad enough to include such risk assessment, and including that assessment will promote frank and open dialogue on this important issue. We further recommend that the Draft be revised to give greater consideration to such risks and that the proposed indicators and tools be designed or modified to capture any adverse impact on global trade and business investment resulting from the BEPS countermeasures.

3. The Draft contemplates the development of new data sources that may be used to develop, extend and refine indicators of BEPS and to assess the scale and economic impact of BEPS. The development of additional new data pursuant to Action 11 raises significant concerns with respect to confidentiality of taxpayer information and the additional burdens to be placed on MNEs. Our concerns are heightened by statements in the Draft that appear to propose the sharing of MNE tax return information and the accumulation of such data into electronic databases. Prior to formulating recommendations for the development of new data for use in Action 11, Working Party 2 should first evaluate the extent to which the extensive new information reporting requirements under the various Action items already satisfy the data needs.

4. The proposed indicators of BEPS discussed in the Draft are fraught with serious methodological problems that far exceed issues of data quality. The proposed indicators will not provide reasonable indications of BEPS activity or estimates of the scale or economic impact of BEPS or its countermeasures. The indicators will not enable practitioners to distinguish between the impact of alleged BEPS conduct and economically beneficial trade and investment activity wholly unrelated to BEPS concerns. The indicators will also not provide an assessment of situations where BEPS countermeasures have an adverse economic effect on global trade and business investment. We conclude that the severe methodological issues related to the proposed indicators will not be eliminated (or even diminished) through the acquisition of new data. We therefore recommend that the OECD carefully and consistently qualify any interpretation of each indicator with respect to its ability to identify BEPS activities separately from other important economic factors that affect the indicator over time.
5. The two proposed theoretical approaches to measuring the scale and economic impact of BEPS also suffer from severe methodological problems. Both proposed approaches require the construction of counterfactual scenarios that purport to measure tax collections and economic impact in a world without BEPS as compared to a world allegedly impacted by BEPS. To be useful, counterfactuals would need to be developed on a country-by-country basis and BEPS channel-by-channel basis. Construction of such counterfactuals would require a large number of unrealistic economic assumptions. The extent of the unrealistic assumptions would effectively render any results from the application of the two approaches meaningless from a policy standpoint. In our view, the risk of misleading conclusions resulting from such highly theoretical analysis is very great. The severe methodological problems with the two proposed approaches will not be ameliorated by the collection and use of additional data. We therefore recommend that the OECD carefully describe the assumptions required to construct the counterfactuals and the limitations in interpreting the results of the proposed approaches with respect to measurement of the scale and economic impact of BEPS and adopted countermeasures.

6. We elaborate further on these conclusions in the comments provided below.

II. Specific Comments Related to Introduction to Discussion Draft

7. Quoting from the Action Plan, the Introduction to the Draft states that the OECD will establish methodologies to collect and analyze data on BEPS and the actions taken to address BEPS on an ongoing basis. These methodologies include developing recommendations regarding the scale and economic impact of BEPS and ensuring that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

8. While the statement of Action Plan objectives is helpful, we respectfully request that the Action 11 analysis include an enumeration and evaluation of any adverse economic risks to global trade and investment that may result from any BEPS countermeasures adopted. We believe the Action Plan related to Action 11 is sufficiently broad to encompass such an analysis. The results of such analysis and any tools proposed to assist with measuring the potential adverse effects of BEPS countermeasures should be reflected in future Action 11 work product.

9. We observe that, in several places, the Draft discusses the importance of distinguishing between the economic impact of BEPS-related activities versus non-BEPS-related conduct. Non-BEPS factors described in the Draft include economically beneficial investment in both developing and developed countries driven solely by business opportunities and wholly unrelated to BEPS concerns. We agree that distinguishing between the impact of BEPS activities and other non-BEPS factors is critically important in achieving a fair and balanced assessment of the scale and economic impact of BEPS. We are concerned, however, that neither the Action Plan nor the Draft appears to contemplate any prospective evaluation of potential adverse economic consequences that may result from the adoption of BEPS countermeasures, such as reduction in aggregate global trade and business investment and financial flows, or material shifts of such trade, investment and financial flows among countries.
10. In this regard, we note that UNCTAD recently published a working paper that quantifies the significance of corporate tax payments to the budgets of developing countries, estimated to be $730 billion annually.\(^2\) The UNCTAD working paper states that “taking action on tax avoidance will have effects on international investment that must be considered carefully.”\(^3\) Observing that ongoing anti-avoidance discussions in the international community pay limited attention to investment policy, UNCTAD concludes that the “policy imperative is taking action against tax avoidance while continuing to facilitate productive investment.”\(^4\) Unlike the UNCTAD working paper, neither the Draft nor the statement of objectives with respect to Action 11 considers that BEPS countermeasures could have an \textit{adverse} economic impact on both the level and allocation of global trade and business investment.

11. We respectfully request that the work under Action 11 include the identification and evaluation, on a prospective basis, of the risks that BEPS countermeasures may result in materially adverse economic consequences for the global economy as a whole, and for individual OECD member countries. In addition, we further recommend that the OECD engage in open and frank dialogue with members on this important issue. We further request that the Action 11 objectives declare explicitly that any BEPS countermeasures adopted should be designed to avoid adverse economic consequences for global trade and business investment, and that future Action 11 analyses include the development of tools designed to detect when such adverse consequences may be occurring.

III. Specific Comments Related to Assessment of Existing Data Sources Relevant for BEPS Analysis

12. The Draft states that BEPS “… affects many non-tax variables, including macroeconomic aggregates, such as gross domestic product (GDP) or foreign direct investment (FDI)[.].”\(^5\) Such unproven conclusory statements are very concerning.

13. The objective of Action 11 is to assess whether BEPS has resulted in economic impacts on economic aggregates, such as GDP and FDI. We note that neither the Draft, nor any economic study cited in the Draft, has demonstrated that BEPS has materially impacted any economic aggregate. The view that BEPS has materially impacted any economic aggregate appears to be mere conjecture. Until such time as material economic impacts on economic aggregates have been demonstrated by reasonable economic analysis on a multi-country basis, we respectfully request that the OECD refrain from making such conclusory public pronouncements on this important issue.

3. UNCTAD working paper, at 4;
4. \textit{Id.} at 3;
5. Draft ¶ 12.
14. As stated in the Draft, the scope of Action 11 includes an assessment of existing data sources that might be used to develop indicators of the scale and economic impact of BEPS and its countermeasures. The Draft further states that Action 11 “involves the identification of new types of tools and data that should be collected in the future. New data could include capitalizing on existing data that is currently unavailable, either due to confidentiality reasons or because it is not currently processed or analyzed, as well as additional information needed for monitoring BEPS in the future, taking into account ways to reduce administrative costs for tax administrations and businesses.” Although the Draft stops short of making specific recommendations for the collection of new data, the discussion makes clear that such recommendations are likely to be forthcoming and that they may relate, at least in part, to confidential taxpayer information.

15. In prior comments, we noted that the BEPS Action Plan (and various discussion drafts) already impose significant new reporting obligations on taxpayers, including more extensive transfer pricing documentation, CbC reporting requirements, and mandatory disclosures of aggressive or abusive tax transactions, arrangements, or structures. Tax administrations will also likely be receiving new data in the form of spontaneous exchanges of tax rulings on preferential regimes. We strongly recommend that the OECD first analyze the usefulness of these data sources for purposes of Action 11 before recommending the introduction of any additional data requirements on taxpayers or the sharing of additional existing information among tax administrations.

16. Our greatest concerns relate to any future recommendations related to the sharing of confidential tax return information. The Draft explicitly states: “Additional analysis of tax return information is needed.” The Draft goes on to state that, “although corporate tax return data has been provided by companies to government tax administrations, it is not currently available in easily accessible form for tax policy analysis.” Although the Draft does not specifically recommend the sharing of tax return information by tax administrations on a broad scale, or the creation of a large scale database to provide easy access to such return information, the Draft discussion clearly suggests that such proposals likely will be forthcoming.

17. Any proposal to develop a global database of tax return information raises substantial concerns over the confidentiality of taxpayer information. We respectfully request that the OECD refrain from making recommendations for further sharing of taxpayer tax return information or the construction of a large scale database of such for ease of access by analysts. While we appreciate the need to develop better tools to analyze BEPS, such tools must respect the framework that exists for sharing taxpayer information between governments, including the limitations on the purposes for which such sharing may occur and the use restrictions and confidentiality obligations that attach to such shared information.

18. Chapter 1 of the Draft sets forth several important criteria by which the usefulness of data may be evaluated with respect to measuring the scale and economic impact of BEPS and its countermeasures. These criteria include factors such as (i) data coverage and representativeness, (ii) usefulness for separating real economic effects from tax effects, and (iii) the ability to focus on specific BEPS activities. We agree that these are important criteria for evaluating the usefulness of data with respect to measuring the scale and economic impact of BEPS.

7. Draft 42.
8. Draft 44.
19. With respect to data coverage and representativeness, the Draft provides: “Incomplete coverage of firms for any number of reasons means that the data collected may be from a non-random sample and so, potentially, a non-representative sample of firms.”\(^9\) We agree that coverage and representativeness is an important criterion.

20. Much of the data on MNEs available through government and private databases is obtained from the financial filings of public companies. Very little information is available about private, closely-held companies, or for businesses operated through partnerships, joint ventures, or other non-corporate structures. In addition, most of the publicly-available financial information relates to businesses operated in corporate form. The principal use of publicly-available data for MNEs operated in corporate form represents a non-random sample of financial data that could potentially bias the assessment of the scale and economic impact of BEPS.

21. Other non-random elements of the publicly-available data may also contribute to biased results. For example, companies report financial data differently across countries depending whether US GAAP, IFRS, or other country-specific financial reporting requirements are used. In addition, the extent of information available, even about public companies, varies significantly across countries. For example, US and European public companies make available substantially greater information than public companies located in other regions and countries. The greater amount of information available about US and European MNEs likely explains why most studies rely heavily on such information when analyzing the presence and scale of profit-shifting in response to differential tax rates. We respectfully submit that the issues related to non-random and biased data samples are important and unlikely to be resolved through the collection of additional data.

22. An additional criterion relates to the usefulness of the data in separating real economic effects from tax effects. We agree that this is an important criterion.

23. As noted in the Draft, there are three different categories of economic effects that must be separately estimated: (i) real economic activity across countries independent of tax effects, (ii) real economic activity across countries influenced by differences in non-BEPS-affected tax rates (e.g., responsiveness of capital investment to a change in a country’s effective tax rate), and (iii) BEPS-related activities. As noted in the Draft, only the third category of economic effects should be attributed to BEPS.\(^10\)

24. We agree that it is critical to separate the effects of other important tax and economic factors that may affect economic activity, such as global trade and business investment, from the effects caused by BEPS. Without controlling for myriad other economic factors that impact investment activities and economic aggregates, it is impossible to isolate specific economic effects related to BEPS. Estimates of the scale and impact of BEPS without controlling for the many other critical economic factors would render the analysis, and conclusions drawn from such analysis, meaningless.

25. However, as evident from the many economic studies cited in the Draft, controlling for the many other economic factors is an extremely complex and difficult task. Indeed, no studies have demonstrated a defensible methodology for controlling for non-BEPS factors across a large number of countries, economic conditions, and industries as would be required to assess the scale and impact of BEPS. Given that so many talented researchers have been unable to articulate such a global approach, it is hard to understand how the OECD will be able to overcome these substantial difficulties and develop defensible methods to overcome the difficulties that other researchers have so far been unable to do. We observe that it is unlikely that additional data will enable analysts to overcome the complexities associated with controlling for myriad other economic factors and separately measure the scale and impact of BEPS and its countermeasures with reasonable accuracy. Perhaps the OECD should consider whether it has set forth a task that is impossible to accomplish even with the acquisition of new data.

\(^9\) Draft 10

\(^10\) Draft 13
26. The likelihood that recommendations will be forthcoming regarding the acquisition of new data raises several important concerns. The collection of new information would be burdensome to taxpayers on top of all of the other information requirements proposed under the overall Action Plan. The collection of new information also raises significant concerns regarding the confidentiality of taxpayer information. The new information likely would suffer from the same data concerns related to timeliness, scope, representativeness, disaggregation, distinctions between tax and financial reporting, and the ability to distinguish between BEPS and other economic impacts. More importantly, additional information is unlikely to eliminate or diminish the severe methodological problems (outlined further below) related to the use of indicators and other approaches to measure the scale and economic impact of BEPS.

IV. Specific Comments Related to Discussion of BEPS Indicators

27. As stated in the Draft, a key component of Action 11 is the development of indicators that can be used “to identify the scale and economic impact of BEPS, to track changes in BEPS over time and to monitor the effectiveness of measures implemented to reduce BEPS.”11 The Draft proposes the development and use of seven indicators (referred to as a “dashboard of indicators”) based, at least initially, on existing data sources. The indicators are described as crude proxies for a more refined and sophisticated estimate of the dimensions of BEPS. We appreciate the OECD’s candor in recognizing that the use of indicators can only provide general indications of BEPS activities, and agree that the interpretation of any such indicators must be heavily qualified by numerous caveats.

28. The Draft contemplates the refinement of the indicators as new information becomes available. According to the Draft, in an “ideal state,” additional and more comprehensive information derived from actual tax return data would be necessary to achieve the most precise estimation of BEPS and its economic impacts using an indicator approach.12

29. As summarized in the Draft, an overriding objective in the construction and analysis of BEPS indicators is “to develop metrics that help portray the extent of practices that artificially segregate taxable income from the activities that generate it.”13 As set forth below, we question whether the use of indicators will enable the OECD to isolate the scale and economic impact of BEPS to achieve this Action 11 objective, separate and apart from the other important economic factors, regardless of the quantity and quality of data available now or in the future.

30. The Draft summarizes guidelines that were used in developing the proposed BEPS indicators. One guideline is that the indicator must be capable of distinguishing “between shifts in profits among countries that reflect changes in real economic activity and BEPS-related transfers of profits that are not in response to changes in the location of real economic factors, labour and capital, that produce that income.”14 Another critical guideline is that the indicator should focus on “tax shifting due to BEPS, not real economic responses to tax rate differences that reflect the impact of current-law provisions adopted by legislators, including incentives to expand business operations in their country.”15 We agree that these are important guidelines for the construction and use of indicators to measure the scale and economic impact of BEPS. We respectfully question, however, whether an indicator approach will ever satisfy these important criteria, regardless of the quantity and quality of data that might become available in the future.

11. Draft 54
12. Draft 62
13. Draft 56
14. Draft 67
15. Draft 68
31. As recognized in the Draft, indicators based on existing data suffer from “signal-to-noise” problems. An indicator that suffers from signal-to-noise problems means that it is difficult to draw reasonable and meaningful conclusions from the level and direction of change in the indicator. Low signal-to-noise means that it is difficult to draw conclusions from the indicator regarding BEPS without substantial caveats. At some point, the level of noise and the extent of the caveats to the indicator analysis render the results meaningless from a policy standpoint.

32. To overcome signal-to-noise concerns, the Draft contemplates refinement of the indicators as new information becomes available. In the “ideal state,” “additional and more comprehensive information derived from actual tax return data would be necessary to achieve the most precise estimations of BEPS and its economic impacts.”

As discussed below, contrary to assertions in the Draft, the sharing and use of taxpayer return data is unlikely to resolve the fundamental methodological problems inherent in the indicator approach. Even if additional data becomes available, indicators will remain an unreliable method for identifying BEPS activities or trends in BEPS activities over time.

33. Before discussing specific concerns related to each indicator, we set forth our general concerns with respect to all of the indicators.

34. We note that all of the indicators are complex in their construction and difficult to understand. In particular, it is difficult to understand how the level of the indicators measures specific BEPS activity or specific channels by which BEPS activities may be occurring. It is also difficult to understand how changes in the indicators measure changes in BEPS activities over time. We further note that none of the indicators will measure adverse economic, collateral consequences that may result from the implementation of specific BEPS countermeasures. The use of multiple indicators will not overcome the fundamental methodological issues related to an overall indicator approach. Moreover, the use of indicators will likely result in a large number of false positives, possibly requiring companies to expend considerable resources to respond to false accusations of BEPS conduct due solely to faulty interpretation of poorly constructed indicators.

35. Specific comments related to each of the seven proposed indicators are provided below.

36. Indicator 1 is calculated as the ratio of the stock of net FDI to a country’s GDP. The indicator compares the FDI ratio in 15 countries (with the highest ratios of FDI) to the ratio for the remainder of the countries. The Draft notes that the 15 countries selected for purposes of the example indicator estimate are mostly countries with no or low corporate income tax rates or preferential rates. The Draft states: “Abnormally high concentrations of FDI to GDP in a country or group of countries may provide an indication of BEPS.”

37. Based on the caveats cited in the Draft, it is difficult to understand how Indicator 1 will provide any meaningful indication of specific BEPS activity, separate and apart from the many forces that affect FDI. The selection of the 15 countries appears to be guided by year-to-year FDI amounts that may change substantially over time. Thus, the composition of the 15 countries may change from year to year, making it impossible to determine whether the level of the indicator is determined by specific trends or merely changes in the composition of the numerator. Further, only a portion of the financial transactions reflected in FDI amounts may relate to BEPS activity, and differences in economic factors driving FDI between developed and developing countries complicate the interpretation of movements of the indicator over time. Indicator 1 will simply provide a numeric value that changes over time without any explanatory power for purposes of identifying the extent, location, and trends BEPS activities.

16. Draft 62
17. Draft 87
38. **Indicator 2** shows the percentage of income earned by affiliates in lower-tax countries with higher profit rates by comparing the profit rate to the ETR of MNE affiliates for the top global MNEs. Indicator 2 focuses on the percentage of total income being earned by lower-tax, higher profit affiliates. According to the Draft, a high percentage of income earned by lower-tax, high profit affiliates is viewed as an indication of BEPS.

39. We agree with the many serious caveats cited in the Draft over the interpretation of **Indicator 2**. The cited caveats include the fact that (i) the indicator cannot differentiate between higher profit rates due to BEPS and higher profit rates needed to ensure competitive after-tax rates of return on investments, and (ii) the indicator does not control for or hold constant other factors that influence BEPS, including variation in affiliate characteristics, such as size and industry. Without controlling for these important economic factors that may determine jurisdictions where investments are made and profits earned, it is hard to understand how **Indicator 2** provides any meaningful indication of BEPS activities. Moreover, changes in the indicator over time are unlikely to provide a measure of the impact of countermeasures adopted, or whether such countermeasures are causing undesirable adverse effects on trade and business investments in various countries.

40. **Indicator 3** compares the profit rate of MNE affiliates in low-tax rate jurisdictions with the MNE’s worldwide profit rate. Low-tax countries are defined as countries with the lowest affiliate ETRs accounting for 20% of the MNE group’s worldwide tax assets. The Draft states that an index number above 1.0 shows that affiliates in low-tax countries have higher reported profit rates than the worldwide rate for the MNE group, which could be an indication that profit shifting into low tax rate locations is occurring. Higher index values are to be interpreted as even stronger indications of BEPS activities.

41. As with **Indicator 2**, there can be many reasons why an affiliate may be earning higher profit rates in a low tax rate jurisdiction separate and apart from reasons related to BEPS concerns. This indicator does not permit separate identification of BEPS activity from the many other reasons that may determine a high index number. **Indicator 3** thus suffers from considerable signal-to-noise concerns and does not provide a meaningful way to identify specific BEPS conduct.

42. **Indicator 4** compares the profit rate differential between the MNE’s domestic and foreign operations to the MNE’s ETR differential between domestic and foreign operations. The specific indicator is the correlation coefficient between the MNE domestic versus foreign profit rate differential and the domestic versus foreign ETR differential. A negative correlation between the profit rates and ETRs is interpreted as an indication of BEPS.

43. This indicator is constructed using financial data for MNE affiliates. Thus, the indicator excludes business activity conducted through non-corporate structures. Differences in book versus tax measurements of income are also prominent, making it difficult to interpret the indicator with respect to BEPS concerns. Thus, as discussed above, the underlying data represents a non-random sample and may contribute to biased indicator results. Year-to-year changes in the correlation coefficient are difficult to interpret and may be due to spurious correlation issues related to the presence of other important economic factors that may determine correlation levels separate and apart from BEPS activities. Overall, it is difficult to understand how the correlation analysis may be viewed as a reliable indication of BEPS activities.

44. **Indicator 5** compares the ETRs of affiliates of top global MNEs in a country with matched, comparable domestic-only firms in the same industry. A value below one is construed as a possible indication of BEPS operating through hybrids and possible other BEPS channels that create a mismatch between financial income and taxable income. The Draft suggests that the indicator will show whether
MNE affiliates that may have greater opportunities for BEPS also have a lower ETR than comparable domestic-only firms.

45. The Draft does not provide example calculations of Indicator 5. The Draft candidly observes that there may be other reasons to explain the level of the indicator or movements in the indicator over time. Cited concerns include the observation that lower ETRs of comparable MNE affiliates may be due to legislated tax differentials or other economic factors that are not being held constant. In addition, there likely will be substantial difficulties in identifying reasonable industry-specific comparable companies fundamental to the construction of the indicator. Without further indication of how such companies will be selected, it is impossible to assess whether the indicator will provide a meaningful indication of BEPS conduct.

46. Indicator 6 focuses on alleged profit shifting through intangibles. The indicator compares the average ratio of royalties received to R&D expenditures for the five countries with the highest ratio to the same ratio for other countries in the sample. A high value of the indicator is construed to suggest that the income stream from intellectual property in the top five countries is significantly higher, relative to other countries, than would be expected given the actual R&D expenditures in these countries.

47. The Draft candidly admits that a significant limitation of the indicator is that current income from intellectual property could be the result of R&D expenditures in prior years. We agree with this frank admission, but do not think that this problem would ever be eliminated with additional data. We also agree with the caveats in the Draft that this indicator does not distinguish between BEPS and other important factors that may determine the indicator levels and changes in the indicator over time. Without controlling for these other factors, the indicator does not provide a meaningful indicator of BEPS activity or an indication of the impact of BEPS countermeasures over time.

48. Indicator 7 requires the calculation of interest expense to income ratio differentials for each affiliate of the top 250 MNEs. The interest ratio differential is the difference between an affiliate interest-to-income ratio and its MNE group’s worldwide consolidated interest-to-income ratio. According to the Draft, when BEPS occurs through interest rate deductions, the interest-to-income ratio differential in countries with above average standard tax rates will be positive. As with the other indicators above, Indicator 7 makes no attempt to control for the many other factors that may drive a ratio amount as of a particular point in time or changes in the ratio over time (e.g., business cycles, stage of market penetration, vintage of debt, fluctuations in interest rates, etc.). Without controlling for such other factors, it is hard to understand how Indicator 7 provides any reliable indication of BEPS activities.

49. Overall, based on our detailed review of the construction of the seven indicators and how such indicators might be interpreted, we conclude that use of indicators (even a group of indicators) is unlikely to provide meaningful indications of BEPS activity or assist with the measurement of the scale and economic impact of BEPS. The indicators also do not appear to be constructed to identify and measure any adverse economic impacts on global trade and business investment that may result from the adoption of BEPS countermeasures. Our concerns over the reliability of this indicator are even more acute if the intention is to apply the approach on an enterprise-specific basis. Significant signal-to-noise issues will always be present due to the many factors that may drive the level and changes in the indicator over time. A larger number of indicators will simply generate a great deal of noise and little meaningful signal. Such problems will not be remedied by additional data.

50. For these reasons, we recommend that the OECD openly and frankly qualify any interpretation accorded the indicators as mechanisms to assess the presence of BEPS activity, or to estimate the scale and economic impact of BEPS over time, by highlighting the myriad other non-BEPS factors that may explain the indicator trends over time.
V. Specific Comments Related to Economic Analysis of the Scale and Economic Impact of BEPS and Countermeasures

51. The Draft suggests that there is a growing body of evidence of the existence of BEPS. However, the Draft admits candidly that estimates of the scale and economic impact are limited. Based on our review of the available studies related to profit-shifting, we conclude that there is indeed little evidence that BEPS activities are substantial and having a material adverse economic impact on any macroeconomic aggregate.18

52. The Draft sets forth two theoretical approaches for estimating the scale and impact of BEPS. Both approaches require the development of “counterfactuals” that permit a comparison of the world with BEPS with an unobservable state of the world without BEPS.

53. The proposed theoretical approaches both suffer from severe methodological issues related to the construction of the counterfactuals. These methodological concerns far outweigh any concerns expressed in the Draft over quality of data issues.

54. We conclude that the proposed counterfactuals will be very difficult to construct and require some rather extreme economic assumptions to make their construction tractable. No one knows whether BEPS has caused a material economic impact of any type, suggesting that it will be conceptually very difficult to construct and quantify a picture of the world where any hypothetical effects of BEPS have been eliminated. To be meaningful, counterfactuals would need to be constructed for multiple countries and for multiple BEPS channels. In addition, analysts would need to construct measures of marginal tax rates for multiple countries and economic entities, something that economists have not been able to accomplish notwithstanding many years of trying to distinguish marginal from effective and standard tax rates.

55. Overall, we conclude that construction of the required counterfactuals would require many extreme assumptions rendering the results of such analysis to be meaningless for policy purposes. Additional or more refined data will not eliminate the practical and theoretical difficulties using the two proposed approaches for measuring the scale and impact of BEPS and its countermeasures.

VI. Recommendations

56. Based on the discussion above, we respectfully offer the following recommendations with respect to the Action 11 objectives and proposed approaches.

57. We recommend that the Action 11 plan be broadened, if necessary, to include an assessment of the risk that any BEPS countermeasures might adversely impact global trade and business investment and distort the allocation of such trade and investment across countries. We further recommend that the Draft be revised to give greater consideration to such risks and that the proposed indicators and tools be designed or modified to capture any adverse impact on global trade and business investment resulting from the BEPS countermeasures.

18. The Draft cites two recent studies relating to tax avoidance and erosion and profit shifting issues: Dharmapala, D., (2014), “What Do We Know About Base Erosion and Profit Shifting? A Review of the Empirical Literature”, CESifo Working Paper Series No. 4612, and Riedel, N., (2014), “Quantifying International Tax Avoidance: A Review of the Academic Literature,” Paper Prepared for the European Tax Policy Forum, mimeo. As indicated by the titles, both papers provide a review of recent empirical literature on these topics. Both papers are also very recent. After discussing the empirical results of various empirical studies, Riedel states: “It is thus too early to draw final conclusions on the quantitative importance of tax avoidance schemes.” In addition, Riedel further concludes that “some care should be warranted when interpreting shifting estimates as they often rely on non-trivial assumptions.” Id. at 1, 7. Dharmapala also notes: “A major theme that emerges from this survey is that in the more recent empirical literature, which uses new and richer sources of data, the estimated magnitude of BEPS is typically much smaller than that found in earlier studies.” Id. at 1
58. Prior to formulating recommendations for the development of new data for use in Action 11, Working Party 2 should first evaluate the extent to which currently available data or the extensive new information reporting requirements under the various Action items already satisfy the data needs.

59. Due to substantial confidentiality concerns, we recommend that the OECD refrain from recommending greater sharing of tax return information (at least in the absence of conditions guaranteeing respect for the framework that exists for sharing taxpayer information between governments, including the purposes for which such sharing may occur and the confidentiality obligations that attach to such shared information) or the accumulation of such information in electronic databases.

60. Because of our severe concerns over the interpretation of the proposed indicators, as well as their inability to distinguish between BEPS and non-BEPS factors, we conclude that the OECD must be very forthright in openly and frankly qualifying any interpretations accorded the indicators with respect to other important economic factors that may determine the indicator level and trend over time.

61. We also recommend that the OECD provide further discussion as to the proposed construction of the counterfactuals required by the two theoretical approaches discussed in the Draft, carefully describing any economic assumptions required in their construction and limitations on the practical interpretation of the results from their use in measuring the scale and economic impact of BEPS.
General Comment

The International Chamber of Commerce (ICC), as the world business organization speaking with authority on behalf of enterprises from all sectors in every part of the world, appreciates the time and effort invested in improving the availability and analysis of data on Base Erosion and Profit Shifting (BEPS) to help facilitate proper monitoring of the implementation of the Action Plan. However, it would have been highly desirable if there had been an appropriate analysis of the magnitudes involved prior to the discussions and proposals being presented within this project. Furthermore, ICC would like to underline that there is a need for an ongoing analysis and discussion of the magnitude of BEPS and the effects of measures taken. ICC therefore very much welcomes Action 11 “Improving the Analysis of BEPS”.

ICC agrees that one of the key challenges with available data sources is that it is difficult to disentangle real economic effects from the effects of BEPS related behaviors. Estimating the effects of BEPS requires a need to establish a counterfactual; i.e. what the outcome would have been without BEPS. There is a need to exclude the effects of real economic activities across countries independent of taxes as well as the effects of real economic activity across countries by differences in non BEPS affected tax rates (e.g. a change in the effective tax rate in the country/countries, introduction of investment incentives etc.).

As stated in the Draft, macroeconomic aggregates, such as foreign direct investment (FDI) include both real and BEPS related investment and returns, which are difficult or impossible to separate. It is also impossible to isolate BEPS related changes in the financing structure from non BEPS related changes. Changes in tax rates may indeed affect the financing mix and leverage of a business. Businesses may thus, cet. par., use more debt financing if the corporate tax rate is higher and more equity financing if the corporate tax rate is lower. ICC notes that this is not a BEPS issue as the financing mix is also influenced by changes in the business risks involved in the investment, government changes in investment incentive schemes and changes in regulations of financial markets and banks.

Despite the recognition that it is impossible to separate BEPS related changes from other changes, the Draft ambitiously attempts to do precisely that. ICC appreciates the OECD’s open and frank recognition of the difficulties and concurs with the need to try to quantify BEPS.

When assessing and monitoring BEPS, ICC believes that it is important to keep in mind, as stated in the Draft, that BEPS behavior is likely to be limited to a relatively small number of cases and concentrated in a limited number of countries. There is scope for governments to take unilateral action to eliminate, or at least diminish, the effects of tax rules that create “bright lines”, opportunities for businesses to engage in BEPS-related activities. One such area is arbitrary rules
for consolidation and loss-offsets – violating the principle of net taxation of profits. BEPS could therefore partly be addressed outside any of the 15 Action points. The Draft does not address how such progress should be monitored or assessed.

ICC strongly believes that analysis of BEPS must not increase the administrative burden of businesses. Although it may seem appealing to try to create very large data bases, to facilitate advanced econometric research, the quality of the data base may suffer if businesses have to provide frequent detailed information. It is vital that tax rules and reporting for tax purposes do not become an obstacle to trade and cross-border investment which would hamper economic growth. Furthermore, ICC urges all tax authorities to take necessary steps to ensure that business sensitive information is confidential and protected.

Specific Comments

Indicator of concentration of foreign direct investment

ICC is concerned that such an indicator cannot distinguish between BEPS and other transactions related to real economic activity. The FDI indicator more than doubled between 2005 and 2012, indicating a disproportionate increase in FDI in countries with a low GDP. ICC questions if such a development should be seen as a problem. Large FDI in low income countries should be welcomed, as well as any cross-border investments. The fact that some of these countries had low corporate taxes should not be an issue – as the Draft states, no or low taxation is not as such a cause for concern.

Indicator 6: Concentration of royalty payments relative to R&D expenditures

ICC notes that research and development include current plus capital expenditures on both public and private research and development (R&D) activities performed within a country. Royalty receipts are payments for the use of intellectual property that may not be directly related to the measure of R&D spending. Furthermore there is a time lag which is not accounted for, and the number of countries included varies over time (ranging from 32 to 69). In addition, it may be questioned whether the cluster effect is due to real activities or BEPS and whether clusters are undesirable. Therefore, the information content in this indicator is likely to be challenged.

ICC believes that the indicators presented in the Draft suffer from a lack of separation of real effects from BEPS related effects. Consequently, it is crucial that the OECD and the media continue to recognise this as the indicators are presented.

The International Chamber of Commerce (ICC) Commission on Taxation

ICC is the world business organization, whose mission is to promote open trade and investment and help business meet the challenges and opportunities of an increasingly integrated world economy.

Founded in 1919, and with interests spanning every sector of private enterprise, ICC’s global network comprises over 6 million companies, chambers of commerce and business associations in more than 130 countries. ICC members work through national committees in their countries to address business concerns and convey ICC views to their respective governments.
The fundamental mission of ICC is to promote open international trade and investment and help business meet the challenges and opportunities of globalization. ICC conveys international business views and priorities through active engagement with the United Nations, the World Trade Organization, the Organisation for Economic Co-Operation and Development (OECD), the G20 and other intergovernmental forums.

The ICC Commission on Taxation promotes transparent and non-discriminatory treatment of foreign investment and earnings that eliminates tax obstacles to cross-border trade and investment. The Commission is composed of more than 150 tax experts from companies and business associations in approximately 40 countries from different regions of the world and all economic sectors. It analyses developments in international fiscal policy and legislation and puts forward business views on government and intergovernmental projects affecting taxation. Observers include representatives of the International Fiscal Association (IFA), International Bar Association (IBA), Business and Industry Advisory Committee to the OECD (BIAC), Business Europe and the United Nations Committee of Experts on International Cooperation in Tax Matters.
OXFORD UNIVERSITY CENTRE FOR BUSINESS TAXATION
MICHAEL DEVEREUX

Comments on
BEPS Action 11 Discussion Draft: Improving the Analysis of BEPS

In my view the single most important factor hindering meaningful statistical analysis of BEPS is the lack of suitable data. The Discussion Draft does an excellent job in setting out the deficiencies of available existing data. So it is disappointing that the Discussion Draft itself does not go further in identifying what data is needed, how it could be collected, and what constraints would need to be overcome to make it available to researchers. This is the key to a successful outcome for Action 11, which after all begins: “Establish methodologies to collect and analyse data on BEPS and the actions taken to address it”.

The indicators that the document suggests fall short of being able to provide convincing evidence of BEPS; and very much short of being able to identify the effects of “the actions taken to address it”. Although the Discussion Paper contains numerous caveats about these indicators, it seems likely that these caveats would be lost in political debate if they are presented as official or semi-official OECD estimates of BEPS.

1. Data

Chapter 1 of the Discussion Draft, “Assessment of Existing Data Sources relevant for BEPS Analysis”, sets out a clear analysis of existing data sources, identifying their relative strengths and their limitations. I will not review the details of the analysis here. But it is worth highlighting some of the conclusions of this review (these quotations are all taken from the list of Key Points in Chapter 1).

- This chapter concludes that the significant limitations of existing data sources mean that, at present, attempts to construct indicators or undertake an economic analysis of the scale and impact of BEPS are severely constrained and, as such, should be heavily qualified.

- While there are several different private data sources and aggregated official sources currently available to researchers, they are all affected by various limitations that affect their usefulness for the purposes of analysing the scale and impact of BEPS and BEPS countermeasures.

- Private firm-level financial account databases are more useful, but are not comprehensive in their coverage, have significant limitations in their representativeness in some countries, do not include all MNE entities and/or all of their associated financial information, and do not have information about taxes actually paid.

- While tax return data covering all subsidiaries of MNES are potentially the most useful form of data, most countries do not have or make such data available for the purposes of economic and statistical analysis, even on an anonymised or confidential basis.

These statements are all justified, and the analysis of Chapter 1 provides detailed support for all of them.

Perhaps, not surprisingly, the concluding element of the Key Points of Chapter 1 is therefore:

- More comprehensive and more detailed data regarding MNEs is needed to provide more accurate assessments of the scale and impact of BEPS.
The most important element of the work on Action 11 should therefore be the creation of new data to support research and analysis of the scale of BEPS.

The main problem with existing data is that it is typically not possible to identify fully (or even anything close to fully) the activities of a multinational company. This is clearly closely related to the issues discussed in Action 13 on country-by-country reporting. Existing datasets created from financial accounts are not comprehensive. Tax return data is typically specific to a single country. There are a very small number of countries which make broader data available, but these are far from comprehensive.

The ideal dataset for the purposes of analysing BEPS would include information on the activities of each affiliate of a multinational group, the ownership pattern within the group, and all the financial flows between the constituent parts. Realistically, it seems unlikely that such a dataset would ever be constructed. There are tradeoffs involved in the construction of new datasets, taking into account cost and confidentiality as well as the benefits of more comprehensive information. Identifying how these tradeoffs can and should be resolved is the single most important issue for Action 11. It is a pity that this has not yet been addressed.

2. Indicators

Chapter 2 of the document sets out “potential indicators that may assist in tracking the scale and economic impact of BEPS over time”. It is hard to see how the use of such indicators in the future can ever be more than illustrative, without the provision of more informative data.

In general, the discussion of the indicators contains little analysis to justify their use, although it does include a number of caveats for each measure. Here I make just a few brief comments on the interpretation of the proposed measures.

a. Indicator 1: Concentration of Foreign Direct Investment

This indicator would calculate the net FDI position for each country as a proportion of its GDP; it would compare the average ratio for the 15 countries with the highest ratios with the average ratio of all remaining countries. The net FDI position is defined as the FDI stock in the country owned by investors from OECD countries, less the FDI stock in OECD countries owned domestically.

It is hard to see how this measure reveals information about BEPS. International flows of debt and equity are included in FDI. Consider, for example, a company that routes financial flows from country A to country B through a tax haven with the aim of ultimately identifying profit as arising in the haven. If A and B were both OECD countries, then it is not clear why this would have any effect on the haven’s net FDI position, so defined. If only A was an OECD country, then there would be a positive effect on the net FDI position in the haven. But if only B was an OECD country, then there would be a negative effect.

The choice of 15 countries is arbitrary. Suppose the number of countries used for routing flows of investment and income increased from 15. Then gross FDI flows to and from the top 15 may diminish; but this may not reflect an increase in, rather than a reduction in, BEPS.

b. Indicator 2: Within MNE Profit Rate Differential

This indicator would calculate a rate of profit and an effective tax rate for affiliates of multinational companies, and also for the consolidated company. The idea is to allocate the consolidated profit of the whole company to 4 categories – affiliates with high and low rates of profit, and affiliates with high and
low effective tax rates. The indicator shows the proportion of total income arising in affiliates that have a high rate of profit, and a low effective tax rate.

Care must be exercised in interpreting this indicator. First, the accounting measures used are subject to numerous definitional problems. An example is the measurement of intangible assets, which would be included in the denominator of the profit rate calculation; typically the accounting treatment can vary significantly, depending on how the company acquired the asset. Second, it is not clear that the comparison would identify BEPs behaviour. For example, suppose an affiliate in a country with a high statutory rate made a high royalty payment to another affiliate. That would reduce recorded profit in that jurisdiction, reducing the recorded profit rate. However, by reducing the denominator of the effective tax rate it would also increase the recorded ETR. Generally, the measured ETR is only informative if the measure of accounting profit used is not affected by the profit-shifting activity. If it completely reflects that profit shifting, then we would expect the ETR to be close to the statutory rate, irrespective of the degree of profit shifting.

But in any case, it is not clear why the ETR should be used at all. The ETR could also be affected by, for example, investment incentives, which are unconnected with BEPS. At the margin the benefit of BEPS in terms of lower tax liabilities should be reflected by the marginal statutory tax rate, not an average effective tax rate. So a comparison with the statutory rate would be more convincing.

Most significantly, though, the process is subject to the missing data problems identified by the document in Box 2, where it is stated that, in the context of using such data:

In a micro-database used by many researchers to analyse BEPS, the financial information for the key affiliate (Y) in the low tax country was missing. This reveals a clear disconnect between the information revealed through targeted public enquiries of some MNEs and the incomplete available financial information for those same MNEs from financial accounts. Much of the important information for tax analysis is simply absent. The fact that such observed instances of BEPS are not visible in firm-level financial account databases highlights concerns regarding the reliability and representativeness of one of the most frequently used existing data sources.

c. Indicator 3: High Profit Rates of MNE Affiliates in Low Tax Jurisdictions

Indicator 3 uses the same data sources and key variables as Indicator 2. The only difference is the way the indicator is constructed. It is therefore subject to the same criticisms as made for Indicator 2.

2. These indicators should clearly not be regarded as providing independent evidence of the extent of BEPS

d. Indicator 4: Profit Rates Compared to Effective Tax Rates for MNE Domestic and Foreign Operations

This indicator uses broadly the same approach as the previous two, except that the comparison is now made with the profit rate and effective tax rate in the “domestic” country. Again, then it is therefore subject to the same criticisms as made for Indicator 2, and again these indicators should clearly not be regarded as providing independent evidence on the extent of BEPS.

Beyond this, it is not clear why a comparison with the “domestic” country adds very much to evidence about BEPS. There are further complications in using the domestic country if that country taxes the worldwide income of the MNE.
e. Indicator 5: Effective Tax Rates of MNEs compared to Domestic Firms

This indicator is again similar to the previous ones, and is again subject to the same criticisms and lack of independence. The merit of this approach depends on how well the MNE can be matched with a set of comparable domestic firms through propensity score matching or other techniques.

f. Indicator 6: Concentration of Royalty Payments relative to R&D Expenditures

This indicator uses country-level macro data on current R&D expenditures and royalty payments received. This is more closely focused on a single BEPS issue — namely the payment of royalties to shift profit to low-taxed jurisdictions. But it is a weak measure. There is a problem of timing — royalty payments are more likely to be associated with past, rather than current, R&D spending. And a company may receive royalties on the use of purchased intangible assets, rather than assets created from its own R&D spending; this is not necessarily evidence of BEPS, but depends on how previous transfers may have been taxed.

As with other measures, the indicator is arbitrary, based on a comparison of the 5 countries with the highest ratio of royalty receipts to R&D spending relative to other countries. It is not clear why 5 is the appropriate measure of comparison.

g. Indicator 7: Interest expense to income rations of MNE affiliates in countries with above average statutory tax rates

This indicator returns to the affiliate level micro data, with the associated problems identified above. Unlike the previous measures using such data, it relies on the statutory rate to identify tax-advantaged jurisdictions. As argued above, this seems more appropriate.

No indication is given of the potential problem that interest received is likely to be a missing variable for many affiliates. It is also not obvious why the sample should be split at the average corporation tax rate. If companies intend to shift income through interest payments, they would presumably aim to shift income to the lowest taxed jurisdictions. This is just another example, of the arbitrary nature of many of these indicators; it should be feasible to design a more general measure.
Dear Mr. Bradbury,

**BEPS Discussion Draft: Improving the analysis of BEPS**

PricewaterhouseCoopers LLP (PwC) welcomes the opportunity to comment on the OECD’s *Public Discussion Draft on Action 11: Improving the Analysis of BEPS*.

We commend the Secretariat and the Working Group for their efforts in realistically assessing the conceptual challenges and data limitations that must be addressed to quantify either the scale or the trend in BEPS activities.

The discussion draft appropriately identifies a number of important caveats in connection with measuring the scale and trend of BEPS activities, including:

- The need to exclude from BEPS measures income attributable to, inter alia, real activity, government incentives, and productivity differences between locations;
- The recognition that book-tax differences do not necessarily reflect BEPS activity; and
- The recognition that recent data are affected by the global financial crisis.

In an appendix to this letter, we have compiled key caveats regarding the measurement of BEPS that are identified in the discussion draft itself.

This letter reflects the views of the PwC network of firms, and we offer our observations on several aspects of the discussion draft.

**1. Observations on proposed indicators**

The indicators highlighted in the discussion draft and referred to below are broadly:

1. Relative concentration of net foreign direct investment (FDI) to GDP
2. High profit rates of low-taxed affiliates of top global MNEs
3. High profit rates of MNE affiliates in lower tax countries
4. Profit rates compared to effective tax rates (ETRs) for MNE domestic and foreign operations
5. ETRs of MNEs compared to comparable domestic firms
6. Relative concentration of royalty payments relative to R&D expenditures
7. Interest expense to income ratios of top global MNE affiliates in high statutory tax rate countries
For two indicators (1 and 6), time trends are reported over the 2005-2012 period. In both cases, the BEPS indicator are coincident with the global financial crisis. Calculating indicators over a longer period of time would be helpful in assessing whether, and to what extent, macroeconomic conditions may affect the BEPS indicators.

For indicator 2, in 2011, it is reported that 67% of top global MNE affiliate income is in countries with high profit rates (relative to the MNE worldwide average), of which 45% is in countries with low ETRs (relative to the MNE worldwide average). Thus two-thirds of income of high profit rate affiliates is reported in low-tax countries (45%/67%). This is taken to be evidence supportive of BEPS. However, among the population of affiliates with low profit rates, an even higher percentage (79%=26%/33%) of affiliate income is reported in low-tax jurisdictions. The smaller share of high profit rate than low profit rate affiliate income in low-tax jurisdictions does not seem consistent with BEPS-related activity.

Many of the indicators have arbitrary elements, for example:

- Indicators 2 and 7 are based on the top 250 global MNEs reporting required information. Why was the analysis cut off at 250? Does it make a difference if available data for all MNEs are used?

- Indicator 3 is based on the profit rate for the lower quintile of a company’s affiliates ranked by ETR. Does it make a difference if the 10th or 30th percentiles are used?

- Indicator 4 is based on an analysis of 25 large MNEs. Would it make a difference if all MNEs for which data are available were analysed?

- Indicator 5 will be calculated only for “top global MNEs in a country” again raising the question whether use of a limited sample affects the results.

- Indicator 6 compares the ratio of royalties received to R&D expenditures for the 5 countries with the highest ratios to all other countries. Why were the top 5 countries chosen? How would the results change if the top quartile, for example, were used? Does the measure of R&D performed include cost sharing payments? Do royalties include those paid with respect to marketing intangibles and other services that are not expected to be related to R&D spending?

2. Response to questions posed regarding indicators

As the very largest MNEs may not be representative, we recommend calculating indicators for all MNEs for which data are available.

Indicators may be significantly affected by inclusion of loss companies in the sample. We recommend that results be reported with and without inclusion of loss companies.

Outliers are a common issue with indicators of the type suggested in the discussion draft. ‘Winsorizing’ the data may be appropriate.

3. Observations on economic approaches to measuring the scale of BEPS

The report correctly observes that measurement of the scale of BEPS activity requires a counterfactual determination of where profits would be reported absent BEPS activity. This requires that the analysis take into account non-tax factors that affect income including R&D, intangible capital, public infrastructure,
industry agglomeration effects, and synergies with other affiliates [p. 61]. However, these factors generally are omitted in academic studies.

Omitted variables can lead to biased estimates of profit shifting:

- “Omitted variable in the analyses will have at least two effects: the explanatory power of the regression will be weak and tax shifting responsiveness may be affected by the omitted variables” [p. 61]

- As noted by Dharmapala [2014], many econometric measures of profit shifting are vulnerable to simultaneity bias, i.e., omitted variables that help determine profitability may be correlated with tax rates. In an analysis that attempted to address simultaneity bias, Dharmapala’s estimate of profit shifting was much lower than the estimates generally reported in the literature.

Based on a meta-analysis of econometric research on profit shifting, Heckemeyer and Overesch (2013) find that studies using company-level data find significantly smaller tax effects on reported profitability. The authors conclude that aggregated data (e.g., at the industry or country level) are associated with misleadingly high tax effects.

PwC agrees with the discussion draft conclusion that multiple approaches to measuring the scale and trend of BEPS activities are better than reliance on a single measure,

> “Given the many uncertainties associated with estimates of the scale and economic impacts of BEPS, using multiple approaches and seeing where their ranges overlap should provide more comfort to policymakers than relying on a single approach or a single data source.” [p. 60]

4. Other economic impacts of BEPS and countermeasures

The aim of public policy should be to improve economic welfare. This requires that policy actions generate increases in economic welfare in excess of costs. The report takes a “balanced budget” approach to analysing BEPS meaning that revenues raised by BEPS are assumed to be used to lower other taxes. Under this approach, the economic benefit of BEPS counter-measures is not the revenue raised, but rather the improvement (if any) in the allocation of economic resources that leads to increased output. PwC appreciates that OECD plans to analyse the full economic impact of BEPS countermeasures including the effects on “economic efficiency and growth … and the burden of … BEPS countermeasures” (p. 71).

PwC notes that it is not clear ex ante that BEPS counter measures will be efficiency enhancing. In particular, proposed changes in transfer pricing rules that more closely align profit with economic activity such as employment and assets may have the effect of increasing investment by MNEs in tax havens.

5. Other issues

The discussion draft (Para. 14, page 7 and Table 1.1, page 10; and Table 2.1, page 34) attempts to make a distinction between “real investment” and investment that includes “mergers and acquisitions and the accumulation of reinvested earnings.” It is not clear what distinction is intended to be made here – FDI through mergers or investment of retained earnings does confer real economic activity to the company which undertakes this FDI.


5. Other issues

The discussion draft (Para. 14, page 7 and Table 1.1, page 10; and Table 2.1, page 34) attempts to make a distinction between “real investment” and investment that includes “mergers and acquisitions and the accumulation of reinvested earnings.” It is not clear what distinction is intended to be made here – FDI through mergers or investment of retained earnings does confer real economic activity to the company which undertakes this FDI.
We hope that these comments are helpful to the Working Party, and we remain available to provide any assistance that the OECD may require.

Yours sincerely,

Drew Lyon
Principal, National Economics & Statistics
PricewaterhouseCoopers, Washington

Peter Merrill
Principal, National Economics & Statistics
PricewaterhouseCoopers, Washington

cc Stef van Weegh, Global Tax Policy Leader

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Key Caveats Raised in the Discussion Draft

Quantifying either the scale or trend in BEPS activities

1. Due to “significant limitations of existing data … attempts to construct indicators or undertake an economic analysis of the scale and impact of BEPS are severely constrained and, as such, should be heavily qualified.” [p. 4]

2. “The use of any indicators to identify the scale and economic impact of BEPS can only provide ‘general indications’ and the interpretation of any such indicators must be heavily qualified by numerous caveats.” [p. 25]

3. “it is difficult for researchers to disentangle real economic effects from the effects of BEPS-related behaviour.”
   a) “Many BEPS behaviours cannot be identified as specific entries on tax returns or financial accounts. … thus, policymakers need economic analyses of BEPS and BEPS countermeasures, rather than just compile descriptive statistics.” [p. 6]
   b) “there are three different categories of effects that ideally would be separately estimated: (i) real economic activity across countries independent of tax; (ii) real economic activity across countries influenced by differences in non-BEPS-affected tax rates (e.g., responsiveness of capital investment to a change in a country’s effective tax rate); and (iii) BEPS-related activities across countries … Only category (iii) effects should be attributed to BEPS.” [p. 7]
   c) “If economic functions, assets, and risks are effectively relocated to another country to take advantage of a low rate or tax credit, this does not constitute BEPS.” [p. 58]
   d) “identifying deviations from arm’s-length pricing is a highly fact-intensive analysis. … Simple descriptive statistics can only provide indications, rather than correlation or causation, of potential BPES behaviours …” [p. 18]
   e) “With the growing reliance of modern business on intangible property and risk as part of global value chains, it becomes more difficult to identify where the activities creating profits take place without better data, careful transfer pricing analysis of individual transactions, and other income measurement rules.” [p. 58]
   f) “Indicators should focus on tax shifting due to BEPS, not real economic responses to tax rate differences that reflect the impact of current-law provisions adopted by legislators, including incentives to expand business operations in their country. Legislated or discretionary tax incentives can have an important impact on reported corporate income tax payments that reflect the location of real economic activity. The challenge in developing indicators is distinguishing between the economic effects and BEPS.” [p. 68]

Book-tax differences do not necessarily reflect BEPS activity [p. 8]

1. “book/tax income differences can include permanent exemption of intra group dividends and timing differences such as accelerated tax depreciation … Differences between the tax consolidation rules and the statutory accounting consolidation rules can affect consolidated accounts”

2. “Due to differences in international tax rules, some companies have tax residence in a country other the country of incorporation”

3. Financial accounting tax expense is “an accrual measure of tax associated with current year income, and which includes both current and deferred income tax expense.” “Cash income taxes
are sometimes reported, but cash tax payments may reflect tax from current and prior years and potentially interest and penalties.”

**Recognizing other analytical challenges, e.g. [p. 9]**

1. “balance sheets typically reflect purchased intangibles only [not self-created intangibles]”

2. “Recent data is impacted by the financial crisis and changing macroeconomic conditions.”
Dear Mr. Bradbury,

RBS RoeverBroennerSusat welcomes the opportunity to submit comments on the Discussion Draft, “BEPS Action 11: Improving the Analysis of BEPS”. We appreciate this opportunity to share our views and hope you find our comments useful in your work on BEPS.

RBS RoeverBroennerSusat supports the aim of the BEPS Action Plan in relation to measuring the scale and economic impact of BEPS. In addition to providing general comments regarding the measurement of the scale and economic impact of BEPS, it is our intention to direct your attention towards specific issues of relevance for small and medium-sized companies (SMEs). In addition we would like to stress that relevant tax data collection mechanisms should ensure data integrity and data protection. From our perspective, a major concern should be seen in the importance of taxpayers’ data protection rights – our respective proposals were included in our comments to the previous Request for Input on “BEPS Action 11: Establish methodologies to collect and analyse data on BEPS and actions to address it”.

Prior to addressing specific questions for consultation, we would like to briefly outline our general evaluation of the Discussion Draft

We consider the Discussion Draft to constitute a sensible follow-up of the preceding consultation process. It presents an instructive and structured summary of the relevant empirical studies and the proposed indicators could constitute a first step in systemizing the further analysis. Considering the preliminary nature of the analysis, we second the conclusion by the OECD that attempts to construct indicators or undertake an economic analysis of the scale and impact of BEPS are severely constrained and as such should be heavily qualified.

On various key issues we found the Discussion Draft to remain rather vague. One example is to be seen in the “future path of BEPS measurement” outlined by the Discussion Draft (p. 28), which reflects a distinct focus on collecting new data, however, without clearly elaborating the process of data collection and respective tradeoffs. The Discussion Draft highlights that the “current state” of BEPS measurement is severely constrained by the limits of available data and that the proposed indicators are of preliminary nature. It is assumed that the quality of the indicators could be enhanced if more comprehensive data were to become available. In this context it would be interesting whether the comprehensive data would exceed the data to be obtained by implementing country-by-country reporting. While implementing the OECD Indicator concept could be a first step in systemizing the analysis of BEPS, the “future state” in which a
more refined analysis of BEPS and targeted counter measures are anticipated to be available is not elaborated upon in detail. The ultimate objectives of the OECD as well as the nature (range) of potential counter measures remain unclear. In other words, we are concerned that the process of collecting more comprehensive data is not sufficiently geared towards specific targets. The collection of more comprehensive data, however, should not be regarded as a panacea or an end in itself. As the collection of additional data is a focal point of the future path outlined by the OECD, we are concerned that respective measures may result in additional compliance burden (reporting, documentation) for taxpayers – specifically SMEs. We hope that these aspects are taken into consideration when evaluating the pros and cons of the ‘Aggregate tax rate differential approach’ and the ‘BEPS channel approach’. In this context a sequential approach that focuses on targeted BEPS channels may minimize the need to collect comprehensive data.

One of our main concerns remains that the current analysis does not sufficiently differentiate between different groups of taxpayers – to the possible detriment of SMEs. The indicators proposed by the OECD focus on highly aggregated data or large (top 500 global) MNEs. Only for Indicator 1 (FDI, p. 32 ff.) did the OECD integrate an analysis of smaller companies as a “possible extension”. We would welcome an extension of the scope of the analysis. Specifically, the analysis should be aimed at determining sensible threshold levels and safe harbor rules to reduce compliance (documentation) burden for SMEs. The relevance of these aspects is particularly evident in the context of addressing the question “How widespread is BEPS activity among corporations?” Respective answers should be adequately reflected in the design of BEPS countermeasures. The OECD references recent studies that reported significant BEPS behaviour by a limited number of large MNEs with affiliates in a small number of jurisdictions (p. 71, point 175). In case these findings are substantiated, we would hope that countermeasures would be more targeted as well as sequenced on tax-avoidance schemes implemented by top global MNEs rather than resembling the current “one-size-fits-all” approach (e.g. Country-by-Country Reporting).

Questions for Consultation

Chapter 1 (p. 19) – Assessment of existing data sources relevant for BEPS analysis

- We consider the criteria for assessing the data to be adequate and see no need to stipulate further criteria. Instead, it would appear sensible to implement an explicit prioritization of the required criteria. In this context the “usefulness for separating real economic effects from tax effects” should arguably be allocated a comparatively high priority with a distinct focus on identifying relevant firm-level data. We welcome the clarification that category (ii) effects should be disentangled from category (iii) effects and that only the later should be attributed to BEPS (p. 7, point 13). In respect to category (iii) effects, however, we would strongly encourage the OECD to be more precise in providing a clear definition of tax structures that are considered as BEPS. The draft explicitly qualifies structures in with “just enough” economic activity (staff and function) is located in a jurisdiction to implement a tax minimization strategy as BEPS. What does the wording “just enough” imply in this context? When the economic substance (notably high value-added functions) is sufficient to reflect the value added allocated to a specific jurisdiction, i.e. value creation is in-line with taxable presence, why would this be considered BEPS? Addressing these fundamental issues must be a first step in the analysis of BEPS. The priority of the criteria of “Timeliness” and “Coverage/Representativeness” appears to be of comparatively secondary importance.

- Existing data should at least allow for conceptually addressing the issue of disentangling category (ii) from category (iii) effects. A starting-point could be extending the analysis of Davies et al. (2014), by including more detailed firm-level data to explicitly address the questions whether transfer pricing is utilized to separate value creation from taxable presence or whether MNEs
adhere to the arm’s length principle and only optimize their tax position by implementing tax strategies that are commensurate with the arm’s length principle. In this context the potential shortcomings of empirical studies should be taken into account, specifically of studies based on the so-called “concealment model” which has been criticized for assuming the existence of a single true transfer price – with the effect that all deviations from this price are qualified as tax avoidance. As a result choices of the taxpayer (e.g. of a specific transfer pricing method) that may in fact be perfectly in line with the arm’s length principle could be qualified as BEPS – thus distorting the actual scale of BEPS. In sum, it appears feasible to gain a better understanding of the scale of BEPS by extending the scope of existing analysis without (or with limited) new data. An alternative approach for extending the existing analysis is outlined by Becker and Davies (2014, “A negotiation-based model of tax induced transfer pricing”).

Chapter 2 (p. 48) – Discussion of Potential BEPS Indicators

- Whether the indicators should be reported globally, by country or by industry should be decided on a case-by-case basis (a unified level of reporting appears unnecessary at this stage). In case the BEPS channel approach is implemented, indicators should as far as possible relate to specific channels.

- Indicator 1 (concentration of FDI) should be excluded. The indicator can (at most) flag potential BEPS. The decisive caveat is that the indicator cannot distinguish between BEPS and transactions related to real economic activity. Considering that BEPS is already on the agenda, the “value” of country specific flags appears negligible. Moreover the indicator will not contribute the analysis of BEPS and appears to be susceptible to year-on-year fluctuations (e.g. consider the development from 2011 to 2012). Similar reservations apply to Indicator 6 (concentration of royalty payments). On the other hand, tax gap measures based on the comparison of national income account corporate data and reported corporate income taxes as well as extrapolations of current-law tax audit assessments could be integrated as new BEPS indicators. The respective results would be reported on country basis (depending on data availability) – as outlined above, we do not consider “Coverage/Representativeness” to be a high priority criterion at this time.

- When considered together the indicators will provide sufficient information for the existence of BEPS as well as possible indication in regards to the geographic distribution and main BEPS channels. At this stage, however, the indicators appear insufficient for deriving a credible quantification of the economic impacts of BEPS. In a subsequent step, it would be required to isolate category (iii) effects – e.g. Indicator 2 and Indicator 3 (by addressing the caveats pointed out in the draft).

Chapter 3 (p. 74)


- For an exemplary reference of an additional analysis of BEPS, see above.

- At this time it is difficult to evaluate whether internationally-coordinated counter measures are likely to increase or decrease the compliance costs relative to future country tax rules. We would, however, as pointed out above welcome a more SME conscious approach in designing counter
measures. By stipulating *safe harbor* or *de minimis* regulations, an internationally-coordinated approach could make a significant contribution to reduce compliance costs. More (visible) efforts should be devoted to minimize compliance costs.

In order to conclude, RBS RoeverBroennerSusat wants to point out that empirical studies on tax evasion, including its definition, have to be treated with caution. The OECD should ensure that the costs for collecting and analyzing data are reasonable as compared to the expected outcome. This is especially relevant if collecting data means that taxpayers have to bear the cost. In this case SMEs would probably have a relatively higher burden than big companies.

We remain at your disposal for any further discussion of these issues.

Yours sincerely,

RBS RoeverBroennerSusat GmbH & Co. KG
Wirtschaftsprüfungsgesellschaft
Steuerberatungsgesellschaft

Gertrud R. Bergmann
Diplom-Kauffrau
Wirtschaftsprüfer
Steuerberater
Partner

Marcus von Goldacker
Diplom-Kaufmann
MBA (International Taxation)
Steuerberater
Partner
Dear Mr. Bradbury,

I would like to thank you for the opportunity to provide comments on the Public Discussion Draft BEPS Action 11: Improving the Analysis of BEPS, issued April 16, 2015.

As an archival empirical researcher who publishes research on international tax planning, I read the discussion draft with great interest. I believe my expertise may allow me to provide some helpful comments as the committee continues its important work.

To summarize my main points,

- a strong definition of “real economic activity” will be essential to effective calibration of BEPS activities;
- the report overstates the implications of academic research on BEPS;
- the metrics do not capture intangible assets or risk; and
- many of the indicators make implicit assumptions about the distributional characteristics of the underlying economic variables that may be highly sensitive to extreme observations and loss entities.

I hope that my thoughts will aid the committee with its work. Sincerely,

Kenneth J. Klassen,
Director Deloitte Professor
kklassen@uwaterloo
1. Measuring the magnitude of base erosion and profit shifting (BEPS) is an important task. If the responses to the BEPS issues are to be appropriate to the size of the problem, metrics of that magnitude are needed. As the report points out, there are widely varying estimates in the literature, and often the estimates are not and in many cases, cannot, be extrapolated to an economy or even sector.

2. As I have undertaken various research projects, I have confronted the lack of data available across countries, types of entities, entity ownership characteristics, and level of disaggregation. I am very sympathetic to the challenges of computing reasonable metrics from limited data. In the paragraphs that follow, I try to provide my perspective on the ideas provided in the report.

**Defining Real Economic Activity**

3. Starting with a definition of BEPS, as in paragraph 55, is a critical step. The definition identifies BEPS as "arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place…" A significant challenge in determining appropriate metrics is identifying the jurisdictions where the profit creating activities are. The paragraph goes on to indicate that the “location of the underlying real economic activities that generate those profits” is the key factor to calibrate BEPS.

4. Box 1 and throughout the documents: "real economic activity" is frequently referenced as the foil to BEPS activity. I think the distinction is helpful and in particular the delineation in paragraph 13 is good. However, in Chapter 2, for example starting in paragraph 67, this concept is narrowed to "GDP, sales, employment or the amount of capital used by firms.” In paragraph 90, the measures suggested are assets, employment, labour compensation, operating expenditures and sales. It is a challenge to measure the economic activity that should form the basis of assessing the appropriate amount of profit, however, it is critical in one way or another to all of the metrics proposed.

5. Box 5 rightly points out that balance sheets, whether from financial accounting or tax statements, rarely capture intangible assets and in particular intellectual property. Indicator 6 implies that current R&D is a reasonable measure of royalty generating intellectual property. The work of Professor Bronwyn Hall, University of California at Berkeley, would aid in refining these measures. I would encourage efforts to incorporate intangibles into the metrics, or assessment of BEPS will necessarily focus on tangible assets rather than a broader sense of the economic activities of firms and jurisdictions.

6. A measure based on R&D or patent activity does not reflect intercompany sales of intellectual property. Intellectual property is often transferred across jurisdictions to set the stage for BEPS. However, sales of such property at fair market value may occur for other valid business reasons and so should be considered in the metrics, BEPS Action 8 focuses on the transfer of intangibles, suggesting that such transfers should not be ignored in the metrics. Including them in the metrics is a difficult task. As a starting place, there are several papers that describe the valuation of intangibles:


While neither of these papers identifies a straightforward way to estimate the value of intangibles at the entity level, or even country level, efforts to determine an estimation method is important.
7. The inter-company transfer of intangible assets should be captured on the affiliates financial statements. These data could be combined with an estimate of internally generated intangible assets through the use of R&D, as described above in 5, to allow for intellectual property to be included in the various metrics.

Academic Research on BEPS

8. Paragraph 97 makes reference to the body of academic research on BEPS. Caution should be exercised when concluding that all academic studies have found evidence of BEPS. First, there is a well-known publication bias, making it very difficult to publish papers that do not show a statistically significant relation. What is not known is the number of studies where researchers have been unable to find a relation and abandoned the study.

9. Further, many studies that explore international tax planning are hypothesizing what is referred to in category (ii) of paragraph 13, that is, changes in economic behaviour that result from tax incentives, but are not BEPS per se. For example, in some of my own work we estimate tax motivated income shifting by examining the aggregate ratio of pre-tax profits to sales for foreign jurisdictions, relative to the corporation's worldwide ratio. To the degree that the foreign ratio is related to the effective tax rate, we conclude that there is tax motivated income shifting. Indicator 3 seems to be drawn directly from this research, though Indicator 3 uses rather than sales.

10. To the extent that the denominator appropriately reflects the appropriate base of economic activity, then the metric will capture BEPS. In the case of sales in the denominator, the ratio can be made higher in low tax jurisdictions because value-adding activities are moved to them to a greater degree than sales are. In an extreme example, moving production to a lower-tax rate country where few sales exist would lead to a higher return on (external) sales in that jurisdiction. Of course, if inter-company sales are included in the denominator, then the problem is muted, but not eliminated.

11. With assets as the denominator, the question of intangible assets, as described above and other forms of economic activity, such as workforce, remains.

Specific Comments on the Indicators

12. Many of the metrics split the data and compare the resulting groups. For example, Indicator 1 identifies the 15 most extreme countries on net FDI to GDP. Similarly, Indicator 2 splits the date on effective tax rates (ETR) and Profit Rate Differentials. When data is split in this manner, the resulting indicator is highly sensitive to the distributional characteristics of the underlying data. For example, extreme observations can have an enormous effect on a measure like Indicator 1. One or two countries could easily drive the changes observed and the country with the extreme value may be among the 15 in only that year.

13. In the case of Indicator 2, the "higher profit" quadrants will also have more profit than the "lower profit" quadrants, by construction. Also, due to the construction of the two variables, the proportion of affiliates and the proportion of assets can be quite different in each quadrant, a reference to which is made in the caveats. It is unclear how to interpret each quadrant's total income and what the distribution would be in a world without BEPS.

14. To gain an appreciation for the counterfactual distribution, I undertook the following:

a) I stimulated a data set of 500 "affiliates" where assets were randomly determined on a uniform distribution from 10 to 210, profits were uniform random -3 to 17, ETR was uniform random 5% to 45% if profit was positive and -10% to 30% if profit was negative.
b) I assigned affiliates to "companies" randomly, such that on average there were 10 affiliates per company, making the data set have 50 companies on average. I randomly determined the number of affiliates per company and the number of companies.

c) I summed the affiliates within a company to compute the consolidated assets, profits and taxes.

d) I computed the statistics as described in Annex 2 and summed profits within the quadrants as described in the Annex.

e) I repeated (a) through (d) 10 times.

f) Across the ten simulations, the average proportion of the "lower ETR/high profit" quadrant was 41%. Thus, the outcome for the lower right quadrant is smaller, but close to that reported in the example, Box 6.

g) Of perhaps equal interest is that the "higher ETR/higher profit" quadrant in my simulations had an average of 37% of the profits.

h) It appears that my simulated values of random, independent affiliates yield similar values for the two right quadrants. However, in only one of the ten simulations does the upper quadrant have more profit than the lower quadrant. A t-test of the 10 pairs of ratios rejects the null of an equal ratio at the 1% level using a 2-tailed test.

i) It is important to reiterate that all affiliates were simulated to be completely independent. This is an unrealistic assumption.

j) Further testing using more realistic assumptions on the distribution of the underlying financial variables would yield better insights. However, notwithstanding the observation in (h) and (i), my preliminary suggestion would be that, rather than focusing on the value in the lower right quadrant, compare the values in the lower quadrants to their corresponding upper quadrants. This seems to be more consistent with the non-random way in which the proportion of total income relates to the x-axis.

15. A significant issue with many of the indicators is loss affiliates and extreme values. Whenever a ratio is computed, there are typically a large number of extreme observations that can dramatically affect the results. Many empirical studies drop loss firms or loss affiliates and windsorize the resulting ratios (for example, ETR values above 1 are set to 1 arbitrarily, and those below 0 are set to 0). This procedure is not ideal because it arbitrary resets particular data points. Loss firms or loss affiliates are a challenge because they represent a significant portion of the data (reaching 25% in broader samples of Compustat date, for example, such as in Klassen and Laplante, 2012, referenced in footnote 1).

16. Careful consideration of risks is important. Care is needed in interpreting indicators 2, 3, 4, 6 and 7 because, taken at face value, these metrics implicitly assume equal returns across jurisdictions. That is, it seems that the ratios are expected to be equal between high tax rate and low tax rate jurisdictions, for example, while operating risks may differ dramatically. There may also be business reasons to place riskier assets in low tax jurisdictions.

17. I have a concern that metric 7 captures at least some optimal behaviour that may be tax motivated, but not BEPS per se. In a high tax rate environment, the cost of debt versus the cost of equity tips heavily toward debt. Leverage may be further affected by the risk of the assets note in 16.

Other Comments

18. Paragraph 59 states that it is best to select among correlated indicators, choosing the one with the highest perceived signal to noise ratio. I would suggest that if there are several indicators that are correlated with the underlying construct, factor analysis would efficiently extract the common underlying variable and produce a composite measure with higher signal to noise ratio than any of the underlying indicators.
STEWART Jim
Some Comments on BEPS Action 11: Improving the Analysis of BEPS

From: Jim Stewart,
Associate professor in Finance, School of Business,
Trinity College, Dublin, 2
Email: jstewart@tcd.ie

There are three area of the Discussion Draft 11: Improving the Analysis of BEPS, that I would like to comment on: The use of existing accounting data and how disclosure might be improved; the Bureau of Economic Analysis data; and the issue of firms reporting losses

1. The Use of Accounting Data.

The Public Discussion draft implies that there is a dichotomy between tax return concepts and data and published financial accounts. Par. 28 states:-

“the available financial information reflects accounting concepts, not tax return concepts. As a result, these databases still provide only indirect information about the presence of BEPS (tax return data would provide a more direct source of information)”.

However, accounting data and tax return data should be seen as complementary. Tax authorities routinely examine all available accounting records. The annual report and accounts of companies contains a considerable amount of information relating to tax liabilities. Accounts of public companies provide a reconciliation of the statutory tax rate and ‘effective tax rate’ (defined as the accounting charge in the Profit and Loss account divided by pre-tax profits), using IFRS standards within the EU, and US GAAP in the U.S. Public accounts of US companies have in recent years disclosed greater information about corporate tax payments, including cash tax paid, the foreign and domestic tax charge, and in some cases, for example Apple, tax due on foreign profits if repatriated. This enable various measures of ‘effective tax rates may be calculated for publicly quoted companies. Table 1 shows these calculations for Apple for the period 2006 - 2014.

Table 1: Tax Payments and Effective Tax Rates for Apple ($ million)

<table>
<thead>
<tr>
<th></th>
<th>Group Pre-tax profits (1)</th>
<th>Tax shown in income statement (2)</th>
<th>Cash Tax Paid (3)</th>
<th>Foreign Earnings (4)</th>
<th>Tax on Foreign Earnings (5)</th>
<th>Foreign Tax Savings (6)</th>
<th>ETR1 % (7)</th>
<th>ETR2 % (8)</th>
<th>ETR3 % (9)</th>
<th>ETR4 % (11)</th>
<th>ETR5 % (12)</th>
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<tr>
<td>2014</td>
<td>50483</td>
<td>13973</td>
<td>10026</td>
<td>33600</td>
<td>1489</td>
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<td>24000</td>
<td>602</td>
<td>3898</td>
<td>24.2</td>
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<td>9.3</td>
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<td>16.2</td>
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<td>29</td>
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</table>

Source: SEC Form 10K for various years. The data relates to periods ending September in each year. Definitions of effective tax rate (ETR) used in table (1).

ETR1 = Tax rate as shown in company accounts defined as Tax charge/pre-tax profit from the Income Statement (column 7).
ETR2 = Tax rate defined as cash tax payments (from cash flow statement) / pre-tax profits (column 8).
ETR 3 = Cash tax payment/ (accounting depreciation + pre-tax profit). Depreciation is included in the denominator because depreciation as reported in company accounts is not a tax deductible expense (column 9).
ETR 4 = tax charge on non U.S. profits / Non U.S. profits (column 10). ETR 5 = Tax rate on unremitted profits (column 11).

1. Greater detail is provided in Stewart (2015).
The data in Table (1) illustrates:

1. That the Apple group pays corporation tax (although below the U.S. nominal rate of 35%), but that very little corporation tax is paid outside the U.S. (See Table 1, column 5 and ETR 4).
2. One measure of tax paid on non-US profits (ET4) shows a measure of ‘effective tax rates below 5% since 2007.

Both measures have been in the public domain for several years and may indicate the possible use of BEPS.

Apart from the use of BEPS, measures of effective rates shown above, may also indicate the size of tax expenditures, for example the size of R and D tax credits and various investment incentives.

For non-public companies there is considerable less publicly available information relating to tax payments, for example cash tax paid is generally not disclosed. The key problem arises in relation to those firms that do not make annual accounts publicly available. For example Discussion Draft Box (2) refers to a firm where two/thirds of a groups’ earnings were made in a low tax jurisdiction yet “in micro-databases used by many researchers to analyse BEPS, the financial information for the key affiliate was missing”.

In the case of an Irish incorporated Apple subsidiary, Apple Sales International (whose pre-tax income is identical to that shown in Box 2, p. 15), accounts are not in micro data bases because they are not publicly available. The reason for this is that all Apple subsidiaries in Ireland are incorporated as ‘unlimited companies’ and are not required to publish accounts. Unlimited companies are widely used in group structures of MNE’s operating in Ireland. For example the parent company of Facebook, Google and Microsoft are all unlimited companies incorporated in Ireland.

The number of unlimited companies has grown over time. In 2013 there 4324 unlimited companies in Ireland, 2.31% of all registered companies, in 2012 there were 4202 unlimited companies, 2.27% of all registered companies and in 2007 there 3378 unlimited companies or 1.82% of all registered companies.2

Requiring greater disclosure of tax paid and other accounting data both at group level and at individual subsidiary level, and eliminating the ability to firms to incorporate as ‘unlimited companies’, would greatly help to improve data on BEPS. Disclosure standards require of the extractive industries should be generally applied.

2. The Bureau of Economic Analysis (BEA) data

The Bureau of Economic Analysis (BEA) data is a valuable source of data on the possible use of ‘profit switching’ and BEPS. The Draft report comments that the BEA data “can include some double counting of affiliated entities” (Box 3, p. 17). Others consider the issue of double counting to be more pervasive in U.S. BEA data. Zucman (2014) comments that:

“In the balance of payments data, profits that pass through chains of entities in Bermuda, Ireland and the Netherlands – like in the “double Irish Dutch sandwich” arrangement- are consolidated and counted only once, in such a way that $1 of foreign profit recorded in the balance of payments directly contributes to national income” (p. 128).

The implication would appear to be that in the case of Google the transfer of royalties from Ireland to the Netherlands results in an increase in profits reported in the Netherlands and and when eventually transferred to Bermuda will result in an increase in profits in Bermuda. In other words the same profits are counted three times (Ireland, Netherlands, Bermuda). However BEA data uses GAAP and uses the “equity method” rather than rules for consolidation of accounts (Blouin et al. 2014, p. 17; Blouin et al, 2012, p. 1470).

Using the “equity method” to account for subsidiaries can result in double counting of assets, but does not result in double counting of profits in relation to intra-firm payments of royalties, management charges and interest payments because they are deducted from revenue in arriving at a measure of pre-tax profits under GAAP.

3. The “Equity Method” of Accounting for Subsidiaries

Using the “equity method” investments in subsidiaries are shown as financial assets. Income is thus not included unless a dividend has been paid. Income from investments in subsidiaries/associates is shown as “other comprehensive income” after showing pre-tax profits and tax payments. One example is accounts of (AOL for 2013). Hence double counting may occur if balance sheet total are used to estimate the stock of investment in different countries and the holding company is included, for example Ireland and the subsidiary is included for example Luxembourg. This is explained as follows by Ibarro-Caton and Mataloni (2014, p. 8), in explaining differences between position statistics for US investment abroad, which have been comprehensively restructured (Borga and Howekl, 2014), and data from BEAs’s surveys of multinational enterprises (AMNE):

“For example, if a U.S. parent company owns two foreign affiliates in a foreign country, a directly held affiliate A and an affiliate B that is indirectly held through affiliate A, the position will capture only the parent’s share of affiliate A’s assets, but the AMNE statistics will capture the total assets of both affiliates, including the portion of affiliate A’s assets that represents its investment in affiliate B. Therefore, affiliate A’s investment in affiliate B is essentially double-counted in the total assets measure of the AMNE statistics”.

Ibarro-Caton and Mataloni (2014, p. 8), further conclude that “These differences strongly suggest that position statistics for certain countries do not accurately represent the level of AMNE in those countries.” They further comment that BEA survey data (AMNE) are classified in the country where the affiliate’s physical activity are located or where its primary activity are carried out” (Ibarro-Caton and Mataloni 2014, p. 7).

BEA data may also result in double counting in relation to intra-firm payment of dividends. Evidence from Ireland indicates that some group structures show neither intrafirm payment or receipt of dividends to subsidiaries in Ireland, for example Google. Other group structures where the Irish affiliate is the parent of a large number of subsidiaries does not involve dividend payments into Ireland, but rather dividends are paid to the parent in the U.S. While other group structures involve payments of dividends from one Irish incorporated entity to another.

BEA data collection and revision provides valuable lessons on developing a comprehensive MNE data base.

3. Firms reporting losses and Effective Tax rates. (par. 96)

The effective tax rate on corporate profits for an individual firm can be defined as tax paid divided by pre-tax profits (T/P). When we try to measure this empirically, abiguities and anomalies immediately arise:-
1. A firm rather than paying corporation tax may receive corporation tax, because for example of overpayments in previous years. Hence the numerator T will be negative resulting in a negative effective tax rate \((-T/P)\);
2. A firm could both receive tax refunds in the current year and report losses in the current year. In this case both numerator and denominator are negative \((-T/P)\) resulting in a positive effective tax rate;
3. A firm could pay tax even though losses were reported. This could arise because corporate tax payments are paid in arrears. Hence the measure of effective tax rates is negative \((T/P)\). This is less likely to occur than in previous years, because lags in corporate tax payments have been reduced;
4. A firm could report positive tax payments but report low profits, resulting in a very high measured effective tax rates \((as \ P \rightarrow 0, T/P \rightarrow \infty)\).

In large data sets all these problems arise. One solution is to estimate effective tax rate over a running three year period. However, anomalies will still remain. A more usual approach is to estimate effective tax rates for only those firms reporting positive profits.

It is likely that these issues are endemic to Irish and other data, but may be less prevalent amongst MNEs. Table 2 shows that for 2012 0.9\% of firms (4420) account for 83.0\% of corporate tax payments. While 65.9\% of all firms account for 1.42\% of corporate tax payments and 37.0\% of firms report zero or negative net trading income. It is likely that there is some persistence in those firms reporting losses. In the sense that firms that report losses in one year are likely to report losses in succeeding years. Finally reported losses by banks will have had a major impact on corporate profitability in Ireland.

**Table 2: The Distribution of Corporation Tax Payments By Irish Companies in 2008-2012**

<table>
<thead>
<tr>
<th>Net Trading Income €¹</th>
<th>2008 % of</th>
<th>2008 % of</th>
<th>2009 % of</th>
<th>2009 % of</th>
<th>2010 % of</th>
<th>2010 % of</th>
<th>2011 % of</th>
<th>2011 % of</th>
<th>2012 % of</th>
<th>2012 % of</th>
</tr>
</thead>
<tbody>
<tr>
<td>€ ≤ 0</td>
<td>7.4</td>
<td>32.9</td>
<td>6.3</td>
<td>38.4</td>
<td>5.8</td>
<td>38.7</td>
<td>3.4</td>
<td>38.9</td>
<td>1.4</td>
<td>37.0</td>
</tr>
<tr>
<td>1 - 25,000</td>
<td>0.6</td>
<td>29.4</td>
<td>0.6</td>
<td>28.7</td>
<td>0.6</td>
<td>29.0</td>
<td>0.21</td>
<td>28.1</td>
<td>0.28</td>
<td>28.9</td>
</tr>
<tr>
<td>≥€10 million</td>
<td>69.8</td>
<td>0.8</td>
<td>73.6</td>
<td>0.9</td>
<td>76.7</td>
<td>1.0</td>
<td>81.1</td>
<td>1.0</td>
<td>83.0</td>
<td>0.9</td>
</tr>
</tbody>
</table>

Note: before 2010 corporation tax refers to tax due plus refunds. After 2010 corporation tax refers to tax due. The data refers to corporate tax ‘cases’.

(1) The Table excludes data on net trading income in the range €25,000 to €10 million. This data defines net trading income as trading profits from a company’s accounts, plus expenses not allowable for tax, minus tax depreciation. To the extent that accounting depreciation is higher than tax depreciation, this figure will overstate pre-tax profits, and conversely. Because this data uses this definition of ‘trading profits’ it could result in biased estimates of effective tax rates. In addition this data excludes those firms that are not domiciled in Ireland for corporation tax purposes (Stewart, 2013, p. 4).


Firms reporting losses (especially on a consistent basis) also need analysis and may be an indicator of BEPS where losses are artificially created or where losses are transferred to a higher tax jurisdiction.
REFERENCES


Dear Mr. Bradbury:

TD appreciates the opportunity to submit comments on the Discussion Draft on BEPS Action 11: Improving the Analysis of BEPS issued by the OECD on April 16, 2015 (the “Discussion Draft”).

Our key points with respect to BEPS Action 11, described in more detail below, are as follows:

- We urge the OECD to do more economic work before the implementation of any BEPS measures. The Discussion Draft serves to underscore the need for more and better economic analysis in connection with all aspects of the BEPS project and for more and earlier attention to be paid to the potential economic effects of proposed counter-measures under the other BEPS Actions.

- The BEPS project has reached a point where it appears that it would be easier to harmonize the tax base and tax rate of all countries than it would be to implement the BEPS recommendations in a coordinated way so that a more level playing field is created for multinational businesses. Therefore, we urge the OECD to add to the work to be done under Action 11 a thorough study of the economic impact of uncoordinated responses to BEPS and inconsistent implementation of OECD-recommended BEPS counter-measures.

- Anti-abuse rules and penalty regimes alone will never be a substitute for close and cooperative relationships between tax authorities and taxpayers.

- Corporate taxpayers already face substantial compliance burdens. We believe it is important for tax authorities to work together to share the information that is already provided and to use the available data more effectively.

- We urge the OECD to ensure that its focus remains on BEPS-related activities that are structured to shift profits away from where value is generated. OECD guidance should target these activities under the BEPS Action Plan.

- The Discussion Draft focuses only on BEPS activity conducted by multinational corporations and does not in any way consider potential BEPS activity conducted through non-corporate vehicles. The OECD should focus on addressing all aspects of BEPS, involving all types of entities.
Overall concerns about the BEPS Project

Before turning to the specific issues with respect to this Discussion Draft, we want to express grave concern about the implications of the pending proposals for BEPS counter-measures under the other fourteen BEPS Actions for cross-border trade and investment and the global economy. Changes of the type being contemplated under the rubric of the BEPS project, and the uncertainty that would be created by abandoning clear standards and principles in favor of vague and subjective concepts, would have a profound adverse effect in terms of stifling global business. We of course recognize the need for governments to raise revenue to support essential government functions. However, they must do so efficiently and without having a chilling effect on essential commerce.

We urge the OECD to ensure that the work on all the BEPS Actions includes full consideration of the macroeconomic and macroeconomic implications of any changes. The OECD has the world-class resources needed to contribute to the global debate by educating participants about the economic, policy, and revenue dimensions of the issues to be addressed and the solutions to be developed. This should go beyond the corporate income tax system and include the whole range of tax approaches available to governments.

The OECD and the countries involved in the BEPS project must not lose sight of the fact that the role of business in the global economy is not to provide revenue for governments. In imposing tax on business to provide government revenue, governments have both a compelling interest and an obligation to minimize the impact on business. The fact that only some businesses are subject to entity level taxes and others are not heightens the government’s obligation to minimize the impact on those businesses that are subject to tax. In seeking revenue from businesses, governments must weigh both the impact of their proposals on particular businesses and the impact across businesses against other approaches to the generation of revenue.

Overall comments with respect to BEPS Action 11

We recognize that the repeated suggestion that the OECD must do more work may not be welcome at this time when the BEPS project is nearing its intended completion date. However, we are more convinced than ever that this additional work is essential. Indeed, we believe that this Discussion Draft serves to underscore the need for more and better economic analysis in connection with all aspects of the BEPS project and for more and earlier attention to be paid to the potential economic effects of proposed counter-measures under the other BEPS Actions. An understanding of the potential economic effects of a possible counter-measure ought to be a prerequisite to any proposal of such measure, whether as an agreed minimum standard or as a consensus recommendation or as a best practice option. If we don't understand the impact, how can we know that a counter-measure will generate more revenue? The counter-measure may very well quash significantly more economic activity and thereby reduce overall revenues.

We also are concerned about the economic implications of the OECD going forward with complex recommendations in fundamental areas of international tax without real consensus and with no formal plan for how to move from recommendations to implementation. The economic ramifications of inconsistent actions across countries in response to the OECD’s recommendations, or inaction by some countries while others do act, are sure to be significant. The competitive landscape will change dramatically if countries respond differently, whether it is because they interpret the OECD recommendations differently or it is because they are following their own self-interest in how they respond to such recommendations. And as we look at the state of the BEPS project in May 2015, it has reached a point where it appears that it would be easier to harmonize the tax base and tax rate of all countries than it would be to implement the BEPS recommendations in a coordinated way so that a more level playing field is created for multinational businesses. Therefore, we urge the OECD to add to the work to be done under Action 11 a thorough study.
of the economic impact of uncoordinated responses to BEPS and inconsistent implementation of OECD-recommended BEPS counter-measures.

**Specific comments with respect to BEPS Action 11 Discussion Draft**

We commend the OECD for the thorough analysis in the Discussion Draft. We also commend the OECD for acknowledging the limitations both of existing data related to BEPS and of traditional analytical techniques with respect to BEPS, whether applied to existing data or applied to new sources of data that potentially could be developed. The recognition of such limitations is important to continuing the focus on trying to develop new data and new analytical techniques. It also is important to broadening the appreciation that there necessarily will be shades of grey with respect to complex cross-border tax matters and that anti-abuse rules and penalty regimes alone will never be a substitute for close and cooperative relationships between tax authorities and taxpayers.

We are concerned about the conclusion in the first chapter of the Discussion Draft that “[m]ore comprehensive and more detailed data regarding MNEs is needed.” Corporate taxpayers already face substantial compliance burdens. Moreover, the compliance burden on multinational corporations will increase significantly with the new country-by-country reporting and master file transfer pricing documentation contemplated under BEPS Action 13. We do not believe further additions to the reporting requirements for corporate taxpayers should be the answer. Rather, we believe it is important for tax authorities to work together to share the information that already is provided and, as the Discussion Draft notes, to use the available data more effectively. One key use of the available data is to better measure the incidence of BEPS.

We also are concerned about the analysis in the second chapter of the Discussion Draft that is built around the view that data showing high investment or high profit rates in lower tax jurisdictions can be considered to be an indicator of BEPS activity. That should not be assumed. High investment or high profit rates may simply be the natural and intended result of competition among countries. We urge the OECD to keep focus on the point made in the first chapter of the Discussion Draft, which stressed that estimating the effects of BEPS requires separating out three categories: (1) real economic activity independent of tax, (2) real economic activity influenced by differences in non-BEPS-affected tax rates, and (3) BEPS-related activities that are structured to shift profits away from where value is generated. As the Discussion Draft rightly states, only the third category of effects should be attributed to BEPS for purposes of any economic analyses. And only this third category should be targeted with measures under the BEPS Action Plan.

Finally, we are concerned that the Discussion Draft focuses only on BEPS activity conducted by multinational corporations and does not in any way consider potential BEPS activity conducted through non-corporate vehicles. There already is a significant incentive to use flow-through or other non-corporate vehicles that are not subject to corporate tax. The new restrictions and burdens to be imposed on corporations through the BEPS Action Plan will exacerbate this inequality of treatment. The OECD should focus on addressing all aspects of BEPS, involving all types of entities. Focusing on corporations and corporate tax, to the exclusion of other business vehicles, would be imprudent and short-sighted. We urge the OED to take a more even-handed approach here.

We appreciate the opportunity to provide these comments on key issues with respect to the Action 11 Discussion Draft. We would be happy to respond to questions or to provide any further information that would be useful as the OECD continues its work in this area.

Sincerely,

Peter van Dijk

Senior Vice President, Tax, TD Bank
PUBLIC DISCUSSION DRAFT: BEPS ACTION 11:
IMPROVING THE ANALYSIS OF BEPS

Introduction

We refer to the above titled document issued 16 April 2015 and welcome the opportunity to comment on this discussion draft.

We note the wide scope of the work in this area. We have not addressed individual questions outlined in the Public Discussion Draft; rather we wish to comment broadly on the issues raised with a particular focus on four of the proposed indicators contained on pages 32-46.

The comments herein continue to reflect our response to the August 2014 Request for Input to BEPS Action 11.

Indicators

The Public Discussion Draft proposes a ‘dashboard’ of indicators that may give broad insights into BEPS and especially changes in BEPS over time. Seven indicators have been identified which might make up the dashboard.

We reiterate the difficulty with indicators is to filter out factors which alter the trends, but which are not related to BEPS project initiatives. The Public Discussion Draft rightly recognises this issue of disentangling real economic effects from the effects of BEPS-related behaviours. This and other factors can alter the trends.
Such factors may include:

- Changes to the tax rate in an individual country.
- GDP growth or shrinkage – there is some evidence in our country\(^1\) that over time there is an average elasticity in the proportion of 1:1.1 between overall tax revenues and GDP.
- Non BEPS project changes to the tax regime in an individual country – this might include new Double Taxation Agreements being concluded, or new incentives such as additional relief for Research and Development. Such developments could mask the consequence of measures within the BEPS project.

Any indicators should also be interpreted in the context of FAQ63 published along with the BEPS deliverables on 16 September 2014 – “The BEPS project is not about increasing corporate taxes… Non- or low-taxation is not itself the concern, but it becomes so when it is achieved through practices that artificially separate taxable income from the activities that generate it.”

We now turn to comment on four specific indicators in the Public Discussion Draft.

**Indicator 1: Concentration of net foreign direct investment (FDI)**

There are many reasons why a FDI decision is made to locate in a particular country. Tax is just part of that overall decision.

The OECD’s 2008 Policy Brief “Tax Effects on Foreign Direct Investment”\(^2\) recognises this specifically commenting that “Tax is but one element and cannot compensate for poor infrastructure, limited access to markets, or other weak investment conditions.”

The concentration of net FDI as a tax indicator might be seen to be indicative of BEPS but should not be a stand-alone indicator.

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\(^{1}\) Report of the Tax Forecasting Methodology Review Group 2008, Department of Finance, Dublin, April 2008

\(^{2}\) Tax Effects on Foreign Direct Investment Policy Brief, OECD, February 2008

**Indicator 3: High profit rates of MNE affiliates in lower tax countries**

This indicator compares the profit rate to the effective tax rate of affiliates of large MNEs.

As the Public Discussion Draft notes, this indicator cannot differentiate between high profit rates due to BEPS vs. other factors, such as risk, that affect rates of return. One potential factor that can drive profitability is the number of employees in the MNE. Such a measure can give an indication of economic substance in a particular location. This might usefully be factored in to indicator 3 as a carve-out where an MNE otherwise has high profitability but is based in a low tax location.

**Indicator 5: Effective Tax Rates of MNE affiliates compared to comparable domestic firms**

This indicator would be calculated using affiliate-level financial statement information on taxes and other financial and economic characteristics. The indicator compares the Effective Tax Rates
(ETRs) of affiliates of top global MNEs in a country with matched, comparable domestic-only firms in the same country.

The Public Discussion Draft does not define how ETR is arrived at. The definition of ETR is a crucial element of indicators 2-5. ETR, and specifically the tax element of the calculation, should be clearly defined and consistently applied across indicators 2-5. We suggest how ETR may be arrived at in the following paragraphs.

There is no doubt that at least some of the impetus for the BEPS project as a whole has been generated by disquiet at the apportionment of tax revenues between countries in which multinational organisations operate. It seems to us that some of that disquiet has stemmed from a lack of agreement as to the best method of computing the apportionment of taxes between territories. At the root of this lack of agreement are disputes over ETRs. Observations and arguments have been generated on the basis of not like for like comparisons.

On the face of it, the computation of the effective tax rate for a company should be a matter of dividing the company profit by the amount of tax paid for the same period. There is legitimate discussion as to which amounts should constitute the numerator and the denominator in this formula.

The analysis may also be carried out either at the macroeconomic level, or at the level of the individual companies concerned. Macro studies arrive at ETRs from aggregate macroeconomic data. Micro approaches either use actual financial statements of the companies concerned, or extrapolations of hypothetical models.

A recent paper published by the Department of Finance in Ireland3 examined instances of each of these three different approaches to the computation of ETRs using model companies, official national statistics and financial reports. The paper concluded that an approach based on national aggregate statistics is the most suitable. Within that approach, it advanced the thesis that measurements based on Net Operating Surplus and Taxable Income best represent the effective Corporation Tax rate in Ireland.

It does not of course follow that these findings necessarily constitute the best approach to effective tax rate measurement in every country. However the approach does ring fence apparent distortions in the effective rate computation which arise because of foreign activity by individual companies. It seems to us that such ring fencing would be essential in tracking the effect of BEPS project initiatives on individual countries and in particular in establishing indicators based on ETRs.

The comparison aspect of this indicator is also critically important. Comparisons must be done in such a way that like is compared with like. At such a high level it will be very difficult to reconcile differences between MNE’s and domestic-only firms. Differences will arise due to sector type, business size and maturity, asset base/usage, research and development policy, profitability levels, product lines and markets served etc.

**Indicator 6: Concentration of royalty payments relative to R&D expenditure**

This indicator combines balance of payments information on royalty payments received by a country and information on the country’s current R&D expenditures. The indicator compares the
average ratio of royalties received to R&D expenditures for the five countries with the highest ratio to the same ratio for the other countries in the sample.

The rational for this indicator is clearly to tackle instances where intellectual property is transferred from a higher-tax country where R&D takes place to a lower-tax country thus facilitating BEPS through cross-border royalty payments to the low tax jurisdiction.

This particular indicator ties in with work currently ongoing within the OECD and the EU in relation to the Modified Nexus approach. Once the outcome of this work has been completed it may be that this particular indicator, whilst still relevant, loses much of its importance in the context of BEPS.

**Additional indicator**

One suggested additional indicator we recommend be considered is the ratio of Corporation Tax receipts to GDP for a country. This is a frequently used existing measurement in international comparisons\(^4\). This potential indicator has the merit of using GDP whose measurement is governed by international standards. The use of existing recognised standards would contribute significantly to the acceptance of measured comparisons existing recognised standards would contribute significantly to the acceptance of measured comparisons.

\[^4\] For example Taxation: Key tables from OECD - ISSN 2075-8510 - © OECD 2013 and Taxation Trends in the EU - ISSN 1831-8789 - Luxembourg: Publications Office of the European Union, 2013

Any comparisons for BEPS purposes would have to be adjusted for the factors mentioned earlier on page 2 (except for the GDP to tax elasticity ratio). We note that this particular indicator was not one of those indicators considered but not included in the Public Discussion Draft as noted on page 47 of same. We would recommend that this is considered for inclusion.

**Conclusion**

**Administrative burden**

In the context of the BEPS Action Plan, improving the availability and analysis of data on measures to counter Base Erosion is no doubt important. But this should not come at the cost of imposing a heavier administrative burden on taxpayers. Significant costs are already incurred by businesses in providing information to tax authorities and meeting existing compliance obligations.

Compliance obligations seek to arrive at the correct amount of tax payable; imposition of additional obligations that sit outside this process would be abusive and costly. In particular no additional reporting obligations or information collection requirements should be imposed as a result of Action 11.

The approach set out in the Public Discussion Draft focuses on what can be done with existing data. Currently there is no proposal to add new data requirements on business. This is welcomed. However the Public Discussion Draft does suggest confidential data could be used or more data
might be necessary. No recommendation is made as to whether business should be asked to provide that. This will need monitoring as Action 11 progresses and the OECD develops its ideas on future enhancements to whatever measures are finally settled on.

The overriding principle in developing these measures should continue to be, as set out in the Public Discussion Draft, “smarter deployment of what already exists” as opposed to new reporting obligations and burdens on taxpayers. Any new measures determined should not require MNE’s to mine information; existing sources of data should be used in preference to requesting further data.

A full impact assessment taking into account the cost and burden for taxpayers and tax administrations should be undertaken before any proposals are finalised. Any economic costs should be more than outweighed by the benefit.

Confidentiality

The confidentiality of information held by tax authorities is also a concern. Though there are currently no proposals to relax this, the Public Discussion Draft describes it as a possibility. This would be a particularly sensitive matter in relation to the comparison aspect of indicator 5.

Country by country reporting under BEPS Action 13 is expected to be confidential; this would be moot if individual taxpayer data from BEPS indicators under Action 11 was released into the public domain. The sharing of taxpayer information should only be done in accordance with exchange of information provisions in tax treaties and other bilateral/multilateral agreements.

Measurement issues

Measures to counter Base Erosion might be relatively straightforward to assess on a global basis. If these measures are effective, it might be expected that over time and all else being equal, aggregate corporation tax revenues would increase, in direct contrast to the stated intentions of the BEPS project.

One area of particular difficulty in measurement might be the level of corporate losses coming forward as a result of the global recession. The tax effect of these losses would have to be absorbed before Base Erosion results become really evident. Effective Base Erosion measures would be expected to result in the more rapid absorption of such losses, but we can think of no way in which that more rapid absorption could be quantified consistently across territories.

Measures to counter profit shifting by definition involve tax revenue shifting. If a company is in the future precluded from moving taxable profit from Country A to Country B, then the corporation tax revenue in Country B would be expected to decrease.

A comparative exercise to determine the effects pre and post-BEPS is also mooted within the Public Discussion Draft (page 30). Whilst this is sensible, unless “pre-BEPS” indicators are sufficiently defined the baseline for comparison will vary dependent on interpretation. Ultimately this would impact on the results obtained from the comparative exercise.

Differentiating between pre & post BEPS behaviours may also not take into account factors such as investment period or policy, losses brought forward, market changes, regulation etc. In essence
many factors will need to be considered to arrive at comparable indicators, if that is actually possible. Perhaps a comparison starting from year 1 BEPS and going forward would be more meaningful.

Whatever methodology is used, there has to be consistency by way of international agreement on the method. The final indicators arrived at should be fit for purpose but equally these should be user friendly and not open to misinterpretation.

The Public Discussion Draft recognises that assessing the extent of BEPS is 'severely constrained'. We conclude that the success or otherwise of BEPS project tax regime changes might well be measured, but will only become evident over an extended period of time.

You may wish to note that these comments are from a representative body. The Consultative Committee of Accountancy Bodies – Ireland is the representative committee for the main accountancy bodies in Ireland. It comprises Chartered Accountants Ireland, the Association of Chartered Certified Accountants, the Institute of Certified Public Accountants in Ireland, and the Chartered Institute of Management Accountants, which represent a combined membership of some 40,000 accountants.

Brian Keegan, Director of Taxation at Chartered Accountants Ireland (brian.keegan@charteredaccountants.ie, +353 1 6377 347) may be contacted if any further details in relation to this letter are required.

Yours sincerely

Paul Dillon

Paul Dillon, Chairman, CCAB-I Tax Committee
UNCTAD

Comments on the discussion draft on BEPS Action 11 (Improving the analysis of BEPS)

Richard Bolwijn
Chief, Business Facilitation Section
Investment and Enterprise Division
UNCTAD
Richard.Bolwijn@UNCTAD.org

Bruno Casella
Economist, Investment Trends Section
Investment and Enterprise Division
UNCTAD
Bruno.Casella@UNCTAD.org

A detailed Working Paper and Technical Annexes explaining the concepts presented in these comments are available at:

http://investmentpolicyhub.unctad.org/
**Proposed new indicators**

**FIRST INDICATOR:** "Indicator of offshore exposure in foreign direct investment"

This indicator may be placed in Section A "Disconnect between Financial and Real Economic Activities" to complement the current FDI-based Indicator 1 "Indicator of concentrations of foreign direct investment".

Section: "Disconnect between financial and real economic activity"

**Indicator:** Indicator of offshore exposure in foreign direct investment.

**Description:** This indicator describes and measures FDI patterns through offshore investment hubs. It requires a preliminary scoping of a set of jurisdictions acting as offshore investment hubs. It is possible to define two subsets of indicators.

- **One-sided indicators** show to what extent investment "to" and "from" standard jurisdictions are routed through hubs as direct partner. More specifically, **inward one-sided indicator** is the share of inward investment stock originating from offshore investment hubs; **outward one-sided indicator** is the share of outward investment stock invested into offshore investment hubs. These shares can be calculated at the level of individual countries or aggregated at regional or global level; they can be "static" (in which case FDI stock are the appropriate metrics) or analyzed across time (using annual or multi-year averaged FDI flows).

- **Two-sided indicator**, available only at the global level, is a composite indicator framed within the "Offshore Investment Matrix". The Offshore Investment Matrix provides a comprehensive distribution of global FDI stock through offshore investment hubs, acting either as investors or as recipients. It also quantifies investment between offshore investment hubs, often a substantial component of BEPS schemes.

**Rationale:** Multinational enterprises realize their BEPS strategies by building complex FDI structures around offshore investment hubs, typically acting as tax-efficient conduits for their financial operations. A larger share of FDI routed through offshore investment hubs may indicate higher exposure to BEPS practices. In essence, corporate structures built through FDI can be considered "the engine" and profit shifting "the fuel" of BEPS schemes of multinationals.

**Data source.** Bilateral FDI statistics. For static analysis (one given year): bilateral FDI stock positions from UNCTAD Bilateral FDI Statistics; IMF Coordinated Direct Investment Survey statistics or (for OECD countries) OECD FDI Statistics. For historic analysis (multiple years): bilateral FDI flows from UNCTAD Bilateral FDI Statistics or (for OECD countries) OECD FDI Statistics.
Box 1. Example of the indicator: Indicator of offshore exposure in foreign direct investment.

**Background.** The presence of BEPS is expected to result in relatively higher share of FDI routed through offshore investment hubs.

**Description.** The analysis quantifies the amount of investments channeled through offshore investment hubs in total FDI stock, at global level and for different groups/regions.

The perimeter of offshore investment hubs comprises two sets of jurisdictions. i. **Tax Havens:** Small jurisdictions whose economy is entirely, or almost entirely, dedicated to the provision of offshore financial services. ii. **Jurisdictions offering Special Purpose Entities (SPEs) or other entities facilitating transit investment:** Larger jurisdictions with substantial real economic activity that act as major global investment hubs for MNEs due to favorable tax and investment conditions. In the absence of any universally agreed approach to classifying offshore investments and investment hub activity, this example has opted for a narrow and conservative perimeter of analysis based on a list of Tax Havens originally proposed by the OECD and a limited set of SPE jurisdictions, which are those that have a long-standing record of published SPE data (self-reported SPE-jurisdictions).

Alternative FDI-based methodologies for scoping offshore investment hubs are possible, for example through the identification of jurisdictions with disproportionately high ratio of FDI stock over GDP (similar to current Indicator 1 Concentration of net foreign direct investment to GDP, but employing gross FDI positions).

**Data used.** The analysis is based on bilateral inward FDI stock from the Coordinated Direct Investment Survey (CDIS) of IMF, with reference year 2012. The sample consists of 104 reporting countries representing more than 90% of global inward FDI stocks. Unlike UNCTAD FDI Statistics, CDIS IMF includes also direct investments from/to SPEs.

**Results.**

*a. One-sided analysis.*

- Globally some 30% of FDI inward stock – including investment through SPEs – is routed through offshore investment hubs before reaching their destination as productive assets.

- The offshore exposure in FDI is similar for developing and developed regions (at 30% of FDI stock).

*b. Two-sided analysis.*

- Some 50% of global FDI stock “pass through” offshore investment hubs, acting either as recipients or as investors. Around one tenth is represented by investment between hubs.

Figure 1 exemplifies the one-sided version of the indicator and shows the average share of FDI stock from offshore investment hubs for different developing and developed regions. Figure 2, based on the two-sided indicator, provides at global level a comprehensive mapping of investment from/to offshore investment hubs.
Figure 1. *One-sided indicator* - Share of FDI stock from selected offshore investment hubs, 2012

<table>
<thead>
<tr>
<th>Investment recipient by region</th>
<th>FDI stock from Tax Havens</th>
<th>FDI stock from SPEs</th>
<th>Share of total FDI stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global</td>
<td>11</td>
<td>19</td>
<td>30%</td>
</tr>
<tr>
<td>Developed economies</td>
<td>3</td>
<td>26</td>
<td>29%</td>
</tr>
<tr>
<td>Region 1</td>
<td>3</td>
<td>32</td>
<td>35%</td>
</tr>
<tr>
<td>Region 2</td>
<td>2</td>
<td>16</td>
<td>18%</td>
</tr>
<tr>
<td>Developing economies</td>
<td>21</td>
<td>9</td>
<td>30%</td>
</tr>
<tr>
<td>Region 3</td>
<td>12</td>
<td>12</td>
<td>24%</td>
</tr>
<tr>
<td>Region 4</td>
<td>25</td>
<td>6</td>
<td>31%</td>
</tr>
<tr>
<td>Region 5</td>
<td>8</td>
<td>19</td>
<td>27%</td>
</tr>
</tbody>
</table>

Analysis based on IMF CDIS 2012 and 2011.
Note: The set of investment recipients does not include offshore investment hubs.

Figure 2. *Two-sided indicator* - Bilateral investment stocks by type of investor and recipient, global
(Offshore Investment Matrix)

Analysis based on IMF CDIS 2012 and 2011.

Caveats.
• The definition of the perimeter of offshore investment hubs is instrumental to a quantification of the investment dimension of BEPS and, as such, responds to analytical purposes. No policy implications should be implied by the scope of the perimeter for offshore investment hubs used in this analysis.

• Offshore investment hubs identified in this analysis are not alone in offering certain tax benefits to foreign investors; a degree of tax competition has led many other countries to adopt similar policies.

• Conduit jurisdictions are part of a broader "system". The patterns and size of transit investment flows are determined by tax policy characteristics of base (home) countries, conduit (transit) countries, and source (host) countries alike.

• The scoping of SPE-countries based on self-reported SPE investment minimizes the level of discretion of the analysis but it sacrifices exhaustiveness. The resulting computation of average offshore exposure should be seen as conservative.

• The number of jurisdictions publishing SPE investment data is increasing rapidly as more countries are aligning to stricter FDI reporting standards. This may have implications on the approach to the scoping of offshore investment hubs going forward.

• Investment links to offshore investment hubs is a signal of the potential presence of BEPS practices, but it does not necessarily prove them. In particular, some of the uses of offshore investment hubs and offshore vehicles like SPEs by international investors are not motivated only by tax considerations (for example, in the case of mergers or joint ventures between partners from different countries with different legal and tax systems, offshore hubs may provide an attractive neutral location for the entity).
SECOND INDICATOR: "Low income rate of return of FDI stock with high exposure to offshore investment hubs"

This indicator may not fit in the current sections; a new section "Profit shifting through direct FDI links with offshore investment hubs" could be considered.

Section: "Profit shifting through direct FDI links with offshore investment hubs"

**Indicator: Low income rate of return of FDI stock with high exposure to offshore investment hubs.**

**Description:** This indicator measures the loss in the profitability of the FDI stock due to high exposure to offshore investment hubs. It can be analytically expressed as the incremental ratio between the FDI income rate of return (computed as the ratio between the equity component of the FDI income and total inward FDI stock) and the share of inward FDI stock from offshore investment hubs (inward one-sided version of the Indicator of offshore exposure in foreign direct investment introduced in Section A).

Based on econometric inference from country-level data, an "average loss of profitability" related to the incremental exposure to offshore investment hubs can be estimated, either at global level or for economic macro-groups (developing and developed economies).

Once a significant relationship is established, a simulation of the tax revenue losses related to BEPS can be done through appropriate assumptions on the profitability gap ("how much FDI income is missing given average exposure to offshore investment hubs") and on the average corporate tax rate.

**Rationale:** The portion of income generated by FDI from offshore investment hubs is subject to a higher degree of profit shifting, with the effect of "artificially" deflating the average rate of return on total inward FDI. Thus, ceteris paribus, the higher the share of inward investment stocks from offshore investment hubs, the lower the rate of return.

**Data source.** Bilateral FDI stock positions from UNCTAD Bilateral FDI Statistics, IMF Coordinated Direct Investment Survey statistics or (for OECD countries) OECD FDI Statistics. Data on FDI income from IMF BoP Statistics.
Box 2. Example of the indicator: Low income rate of return of FDI stock with high exposure to offshore investment hubs

**Background.** High exposure to *offshore investment hubs* is expected to be negatively correlated with the income rate of return on FDI stock because of profit shifting.

**Description.** The analysis measures the decrease in the FDI income rate of return (equity component) related to an “incremental unit of FDI exposure” to *offshore investment hubs*. The analysis is performed at global level, at the level of developed countries and of developing countries.

The perimeter of the *offshore investment hubs* includes *Tax Havens* (see Indicator in Section A) and other relevant investment hubs selected through the "implied investment method", an empirical and FDI-driven methodology designed to identify jurisdictions acting as global offshore investment hubs with exceptionally large transit investment (see methodology illustrated in Working Paper, Annex II).

The relationship is established through econometric inference from country-level data. The fitted model is a linear regression where the explicative variable is the share of FDI stock from *offshore investment hubs* ("offshore share") and the dependent variable is the (equity) income rate of return on the FDI stock ("rate of return"); the linear coefficient $\beta$ (slope) is then the target indicator. A number of econometric techniques (including fixed effects and control variables) were also implemented to ensure the robustness of the estimation.

**Data used.** Each data point is a country/year pair of the explanatory and the dependent variable (offshore share, rate of return), recorded for 72 countries across four years (from 2009 to 2012). The size of the sample is limited by data constraints either on bilateral FDI statistics (from IMF CDIS) or on FDI income data (from IMF BoP statistics).

**Results.**

- There is a linear negative statistically significant relationship between offshore exposure in FDI stock (Indicator of offshore exposure in foreign direct investment) and FDI income rate of return (equity component).

- On average a 10% share of inward investment stock originating from *offshore investment hubs* is associated with a 1pp - 1.5pp lower reported (taxable) rate of return.

- The estimated loss of profitability in FDI stock due to incremental exposure to *offshore investment hubs* is higher for developing economies than for developed economies.

Figure 1 illustrates the main relationship between offshore exposure and rate of return; Table 1 shows the estimated indicators.
Figure 1. Illustration of the relationship between the share of inward investment from offshore investment hubs (offshore exposure) and rate of return on inward investment


Table 1. Estimated indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Estimates</th>
<th>Interpretation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Low income rate of return of FDI stock with high exposure to offshore investment hubs</td>
<td>Global -0.126, Developing -0.158, Developed -0.084</td>
<td>Decrease in the FDI income rate of return (equity component) related to an &quot;incremental unit&quot; (1 percent point) of FDI exposure to offshore investment hubs</td>
</tr>
</tbody>
</table>

Caveats.

- The BEPS effects captured by the indicator are mostly confined to those associated with tax avoidance schemes that require a direct investment relationship through equity or debt, such as financing schemes. Other BEPS schemes, like trade mispricing, do not necessarily require a direct investment link. This indicator is thus complementary to other indicators signaling BEPS practices that do not require a direct investment link.

- This indicator provides empirical underpinning to widespread evidence that MNEs leverage direct investment links to offshore hubs. However, interpretation of the underlying relationship in a strictly causal way ("an additional 10% exposure to offshore investment hubs generates a 1pp - 1.5pp decrease in the rate of return") requires caution. As the relationship holds across countries, it is not possible to exclude compositional effects of specific countries driving the results. Further economic and econometric analysis will strengthen the causal nexus behind the indicator.

- This indicator is designed to establish and assess a relationship between FDI and BEPS at the aggregate level (global or developing/developed); the resulting macro-indicator is an average over a heterogeneous sample. Country-specific estimates can only be arrived at through simulation. Applying the indicator to draw country-specific policy implications requires caution.

Specific comments

In the following some punctual comments on the current version of Public Discussion Draft "BEPS ACTION 11: IMPROVING THE ANALYSIS OF BEPS". The comments focus on selected parts of the draft related to FDI.

1. Page 10, table 1.1, FDI.

- It would be important to differentiate between standard FDI data and bilateral FDI data. Standard FDI data allow sizing the amount of investment from/to countries while bilateral statistics allow tracking FDI patterns (where they come from and where they go). For BEPS bilateral data are more informative.

- The statement "There is no distinction between real and financial investment ..." referred to FDI data would require some qualification of what is "real" and what is "financial". An investment from a parent in country A to open a factory in country B made through an intermediate vehicle in country C is real or financial? What part is real and what part is financial?

2. Page 20, Table A.1, Foreign Direct Investment.

- "Source". UNCTAD could be added among the sources of FDI data. In particular for developing economies (stock and flows), UNCTAD data provide the largest coverage.

- "In the BEPS analysis context".

In the bullet points FDI available data are classified in terms of stock (first bullet) and flows (second bullet - income flows, third bullet - financial flows). It may be better to use the more standard classification FDI stock, FDI flow and FDI income.
FDI income is listed (second bullet) as part of FDI statistic but it is not addressed further (its potential use in BEPS studies is not discussed, sources are not provided). However it is a potentially important source of information on BEPS.

The last statement "Data from IMF CDIS lack sufficient detail to compare profit declaration with value creating activity" should be clarified.


- The choice to employ net FDI position (difference between inward and outward FDI stock) instead of gross FDI position (e.g. inward FDI stock) needs clarification. As acknowledged in the "Caveats", it does not allow capturing BEPS schemes based on conduits. For an indicator that aims at capturing FDI-related BEPS schemes, this is a critical limitation. The argument supporting the use of net instead of gross - that it allows "focusing on the resting point of FDI" - seems much weaker.

More generally the choice of net FDI instead of gross limits the scope of BEPS practices that can be addressed by this indicator. If a no or low-tax country is "used" as a final destination for FDI, both the analysis of gross FDI and net FDI should be able to reflect this; however if a low tax country is "used" as conduit, as it is often the case within BEPS, gross FDI show abnormal value of stock compared to GDP while net FDI don't (due to the offset of the positive and the negative part).

- In the example some clarification is needed on the data. i. It could be stated more clearly that the example captures only investment links with the OECD countries. ii. It should be specified whether FDI statistics include investment from/to SPEs.

- The choice to focus on the first 15 countries may appear arbitrary. It could be better to use deciles/quartiles for the selection of the top countries.

- There may be an error in the qualification of net FDI stock in "Data used" in the example.