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Policy Brief

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Taxing Multinational Enterprises

BASE EROSION AND PROFIT SHIFTING (BEPS)

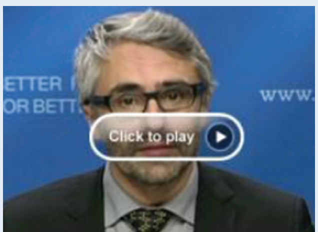
- **Current tax rules** allow multinational enterprises (MNE) to legally shift profits to no- or low-tax jurisdictions where there is little or no economic activity.
- **This activity costs** governments money, distorts competition, can lead to inefficient allocation of resources and undermines voluntary compliance by all taxpayers.
- **BEPS strategies** often take advantage of the interaction between the tax rules of different jurisdictions, so only an internationally coordinated effort can effectively respond to this issue.
- **The BEPS Action Plan** is based on three core principles: *coherence, substance and transparency,* and sets forth 15 actions to fundamentally change the rules for the taxation of cross-border profits.

What's the issue?

Globalisation has opened up opportunities for multinational enterprises (MNE) to greatly reduce the taxes they pay, sometimes close to zero. Gaps and mismatches in tax rules can make profits "disappear" for tax purposes or allow the shifting of profits to no- or low-tax locations where they have little or no economic activity. This activity is referred to as base erosion and profit shifting (BEPS). Moreover, the growing importance of the service component of the economy, and of digital products and services that often can be delivered over the Internet, has made BEPS much easier.

BEPS strategies take advantage of a combination of features of home and host countries' tax systems. Corporation tax is levied at a domestic level. Governments' cooperative efforts to avoid double taxation can also lead to "gaps" which result in income not being taxed anywhere; this is sometimes called "double non-taxation".

These strategies are legal. BEPS is not a problem created by one or more specific companies. Apart from some cases of blatant abuses, the issue lies with the tax rules themselves.



See www.oecd.org/video

"Corporate tax policy, and in particular its international side, may need another look"

Pascal Saint-Amans
Director, Centre for Tax Policy & Administration, OECD

Accordingly, the onus falls on governments to amend and coordinate their tax policies so that MNEs pay taxes on the profits they earn.

Why is this important?

Governments are harmed. By definition, they receive less revenue, and are forced to bear the higher cost of ensuring compliance. Moreover, BEPS undermines the tax system's integrity as the public, the media and some taxpayers deem reported low corporate taxes to be unfair. In developing countries, the lack of tax revenue leads to critical under-funding of public investment that could help promote economic growth. Overall resource allocation, affected by tax-motivated behaviour, is not optimal.

Individual taxpayers are harmed. When tax rules permit businesses to reduce their tax burden by shifting their income away from jurisdictions where income-producing activities are conducted, other taxpayers in that jurisdiction bear a greater share of the burden.

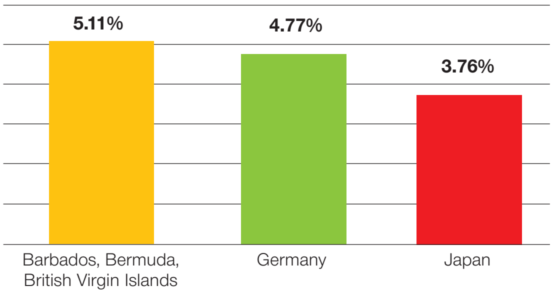
Businesses are harmed. MNEs face significant reputational risk given the recent attention on the way they manage their tax affairs. At the same time, different businesses may assess such risk differently, and failing to take advantage of legal opportunities to reduce an enterprise's tax burden can put it at a competitive disadvantage. Similarly, corporations that operate only in domestic markets, including family-owned businesses or new innovative companies, have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax. Fair competition is harmed by the distortions induced by BEPS.

What should policymakers do?

The solution to this issue lies in changes to current tax rules and requires international co-operation. It is governments'

Signs of tax avoidance by MNEs

Inward foreign direct investment (FDI), % of global FDI, 2010



Source: OECD (2013) Addressing Base Erosion and Profit Shifting

The fact that very small economies attract more FDI than major economies such as Germany and Japan is a sign that MNEs register income in low tax countries that was actually generated in other countries. The OECD Action Plan aims at improving the measure of BEPS by multinationals.

responsibility to revise the rules or introduce new rules and there is a need to provide an internationally coordinated approach to facilitate that. Unilateral and uncoordinated actions by governments could result in double taxation for business, with a negative impact on investment, growth and employment. The BEPS Action Plan aims at maintaining and strengthening the existing consensus-based framework and at ensuring that the global tax architecture is equitable and fair. The BEPS Action Plan sets out 15 actions in these areas to address this issue in a comprehensive and coordinated way. The actions stress the following:

Coherence: Domestic tax systems are coherent–tax deductible payments by one person results in income inclusions by the recipient. We need international coherence in corporate income taxation to complement the standards that prevent double taxation with a new set of standards designed to avoid double non-taxation.

Substance: Current tax rules must be modified to align tax with substance. Existing tax treaty and transfer pricing rules can, in some cases, facilitate the separation of taxable profits from value-creating activities, such as through shell companies that have little or no economic substance. Domestic and international tax rules should relate to both income and the economic activity that generates it. Flaws in the area of transfer pricing should be fixed within the current system. Areas include returns related to over-capitalisation, risk and intangible assets. Special rules, either within or beyond the arm's length principle, may be required in these respects.

Transparency: Greater transparency and improved data are needed to evaluate the impact and magnitude of BEPS. Further, requiring taxpayers to report their aggressive tax planning arrangements and rules about transfer pricing documentation, breaking down the information on a country-by-country basis, will help governments identify risk areas and focus their audit strategies. And making dispute resolution mechanisms more effective will provide businesses with greater certainty and predictability.

The Action Plan also recognises the importance of addressing the tax challenges of the digital economy, which offers a borderless world of products and services that too often do not fall within the tax regime of any specific country, with loopholes that allow profits to go untaxed.

What's next?

The actions outlined in the plan will be delivered in the coming 18 to 24 months by the joint OECD/G20 BEPS Project, which involves all OECD members and G20 countries on an equal footing.

The mechanisms being used to obtain input from developing countries include the OECD Global Fora, the Task Force on Tax and Development, and the OECD Global Relations Programme. A sub-group on BEPS has been set up at the UN level to provide input and look at the issue of implementation. Some important initiatives, including Tax Inspectors Without Borders and a major effort to build transfer pricing capacity, are currently being geared up to help developing countries address the practicalities of BEPS. Business and civil society have been and will be invited to comment on the different proposals developed in the course of the work.

For further information see **www.oecd.org/tax/beps.htm**, or contact **CTP.BEPS@oecd.org**

Sources

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