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OECD Reports on Tax Avoidance: Encouraging Progress, but More to be Done

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A first batch of OECD recommendations on Base Erosion and Profit Shifting (BEPS) – a two-year G20 Action Plan to curb aggressive tax planning by multinational enterprises, to be completed by the end of 2015 – is to be submitted to G20 Finance Ministers meeting in Cairns on 20-21 September and, following that, to the G20 Leaders' Summit on 15-16 November 2014 in Brisbane.

The OECD mid-terms reports are encouraging in as far as effective implementation of the BEPS Action Plan is concerned – considering the tight schedule and the complexity of issues at hand (digital economy, "treaty shopping", "harmful" tax competition between governments, MNE transfer pricing). Ahead of the Brisbane summit, however, G20 government must raise the ambition of the Plan and address some of the weaknesses exposed in the OECD recommendations released this week by:

- **Leaving options open for public disclosure of the country-by-country tax reporting** by MNEs. At the present state, public disclosure, or even partial disclosure, of the reporting framework is not under consideration in the OECD proposal at all. This exclusion will not help rebuild citizens' trust in global businesses' wealth creating mission for societies.

- **Facilitating the participation of developing countries in the BEPS process through concrete institutional support**. The current format for the involvement of developing countries relies exclusively on regional "consultations" and is overall inadequate.

- **Instructing the Financial Stability Board (FSB) to collaborate with the OECD on the taxation of shadow banking and private pools of capital**. In its recommendations, the OECD acknowledges difficulties in dealing with the tax treatment of the shadow banking system (including banks "repo" markets) and of private pools of capital (including private equity and hedge funds). For far too long, the respective G20 Action Plans on tax avoidance and on financial reform have been dealt with separately. It is time for the G20 to step up and engage a comprehensive approach to tax and finance.

Seven BEPS action points (out of a total of fifteen) were delivered by the OECD on 16 September covering: the digital economy (Action 1), a new multilateral convention (15), harmful tax practices to attract foreign investors (5), "hybrid mismatches" leading to multiple deductions from the corporate income basis (2), treaty shopping (6), transfer pricing of intangibles (8) and country-by-country tax reporting (13).

Despite a considerably tight schedule and the complexity of the issues at hand, the OECD reports are encouraging in so far as they suggest that G20 governments remain committed to live up to the expectations raised by the BEPS Action Plan last year including:

- The positive conclusion on the "feasibility" of a **new Multilateral Convention** to automatically align the thousands of existing bilateral tax treaties with the outcomes of the BEPS Plan is particularly welcome. This should shut down the claims made by business groups that the BEPS plan would increase "uncertainty" in global tax and regulatory environments;

- Progress in addressing **mutually destructive harmful tax competition** between governments in seeking to attract foreign capital, including agreement on a common methodology to test the "economic substance" of preferential regimes (such as "patent boxes" in the UK and the Netherlands) as well as on exchange of information on "rulings" (secretive deals between a tax authority and an individual MNE);

- Agreement on a minimum standard set of clauses to be introduced in bilateral tax treaties to prevent "**treaty shopping**" and undue access to treaty benefits through empty shell companies;

- Draft revision of the OECD Transfer Pricing Guidelines regarding the treatment of intangibles;

- Promising avenues on **digital economy** for key deliverables in 2015, notably with regard to preventing the artificial avoidance of the "permanent establishment" status, and allowing for alternatives to the Arm's length principle in intra-MNE transfer pricing of intangibles (intellectual property rights).

The risk is that the process will be watered down, should political leadership and momentum lose steam in the second implementation phase of the Action Plan. Most of the deliverables are incomplete and would need further work and guidance in the year ahead. Beyond that, there are three major concerns with the current OECD deliverables:

- **Corporate transparency**: the proposed country-by-country tax reporting framework – part of the revised set of transfer pricing documentation – is to be filed with tax authorities only. Public disclosure, or even partial disclosure, is not under consideration.

- **The voice of developing countries**: the mid-term reports do not provide concrete provisions on the participation of developing countries in the BEPS process, which has been far too weak thus far – only embedded in regional consultations – and should be facilitated and reinforced in the future.

- **Shadow banking and private funds:** big uncertainties remain on how the shadow banking system (including banks' "repo" markets) and opaque private pools of capital (private equity and hedge funds) are going to be treated in the Action Plan and its deliverables, notably with regard to measures to curb treaty abuse.

The OECD mid-term reports are to be submitted to G20 Finance Ministers meeting in the coming days and will be presented to the G20 Leaders' Summit on 15-16 November 2014 in Brisbane. G20 governments should endorse the OECD reports. However, it remains crucial for them to work further in addressing the above concerns, including: (i) leaving options open for public disclosure of the country-by-country reporting, (ii) instructing the Financial Stability Board to collaborate with the OECD on the taxation of shadow banking and private pools of capital, and (iii) delivering concrete institutional arrangements and capacity building to facilitate the participation of developing countries in the process.

Reference:

- OECD webpage on the BEPS Action Plan: http://www.oecd.org/ctp/beps.htm