TRADE UNION ADVISORY COMMITTEE
TO THE ORGANISATION FOR ECONOMIC
COOPERATION AND DEVELOPMENT
COMMISSION SYNDICALE CONSULTATIVE
AUPRÈS DE L'ORGANISATION DE COOPÉRATION
ET DE DÉVELOPPEMENT ÉCONOMIQUES

The G20/OECD Base Erosion and Profit Shifting Package - Assessment by the TUAC Secretariat

Paris, 30 June 2016

Table of contents

I. Overview 2
Assessing the deliverables 2
Relevance to trade unions 5
Will it work? 6
The implementation phase 9
II. About base erosion and profit shifting 10
The formation of the international tax system 10
The rise of tax competition 11
The many faces of corporate tax avoidance 12
Measuring the impact 16
Why it matters for workers 18
III. TUAC assessment of the BEPS package 18
Action 1 – Address the Tax Challenges of the Digital Economy 20
Action 2 – Neutralizing the Effects of Hybrid Mismatch Arrangements 22
Action 3 – Designing Effective Controlled Foreign Company Rules 24
Action 4 – Limiting Base Erosion Involving Interest Deductions & Other Financial Payments 25
Action 5 – Countering Harmful Tax Practices More Effectively 26
Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances 28
Action 7 – Preventing the Artificial Avoidance of Permanent Establishment Status 29
Actions 8-10 – Aligning Transfer Pricing Outcomes with Value Creation 31
Action 11 – Measuring and Monitoring BEPS 33
Action 12 – Mandatory Disclosure Rules 34
Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting 35
Action 14 – Making Dispute Resolution Mechanisms More Effective 37
Action 15 – Developing a Multilateral Instrument to Modify Bilateral Tax Treaties 38
IV. What to request from MNEs 38
Request access to C-b-C reports and transfer pricing documentation 38
Find ways around confidentiality requirements 39
Request reporting on the OECD BEPS indicators 39
Focus on specific transfer pricing risks 39
Keep an eye out for other BEPS practices 40
About this report 41
References 41

15, rue La Pérouse - 75016 Paris - France
Tel: +33 (0)1 55 37 37 37 - Fax: +33 (0)1 47 54 98 28 - tuac@tuac.org -www.tuac.org

I. Overview

1. On October 5th 2015, the OECD delivered the final set of measures and recommendations on tackling aggressive corporate tax planning, thereby completing the first phase of the 15-point Action Plan on Base Erosion and Profit Shifting (BEPS) adopted by the G20 in 2013.[i] The two-year negotiations process constitutes the most far reaching attempt to reform the international tax system to date. When compared with the status quo ante, the BEPS package brings significant improvements to the system of tax rules, and can rightly be considered a historical achievement on the international regulatory front. However, the standards for such praise are set rather low, given that international tax rules have been left essentially unchanged for almost a century.

Assessing the deliverables

2. Table I contains a summary of the BEPS assessment's key findings as outlined in section III, including the form of the deliverable (analytical report, non-binding recommendation, or binding minimum standard), its pros and cons, its overall assessment, and an estimate of how relevant the deliverable is for trade union action. The assessment criteria are based on whether the final deliverables met the initial expectations and ambition of the 2013 BEPS Action Plan.

Table I: Summary of the BEPS assessment

Action 1: Digital economy	**"Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties"**	
Deliverable: Report / recommendation on VAT/GST (Non-binding) ***Assessment:*** Meeting expectations ***Trade union relevance:*** Moderate	***Pros:*** A comprehensive rundown of challenges arising from the digital economy.	***Cons:*** Stops short of more ambitious recommendations that were on the negotiating table, such as a new digital PE status.
Action 2: Hybrid mismatches	**"Design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities" (e.g. treated as debt in one jurisdiction, as equity in another)**	
Deliverable: Common approach / best practice (Non-binding) ***Assessment:*** Below expectations ***Trade union relevance:*** Low	***Pros:*** Covers a broad set of hybrid arrangements in a technically sophisticated manner.	***Cons:*** It comes at the cost of complexity and is not binding. It will require jurisdictional cooperation that may not be forthcoming in a global environment where tax competition is still considered a virtue.

Action 3: CFC rules	**"Develop recommendations regarding the design of controlled foreign company rules" (including taxation of non-resident subsidiaries, partnerships, trusts, or other entities conveniently based in low or zero tax jurisdictions)**	
Deliverable: Common approach / best practice (Non-binding) ***Assessment:*** Below expectations ***Trade union relevance:*** Low	***Pros:*** Comprehensive set of rules for countries to consider and choose from.	***Cons:*** It is not binding, and without substantial cooperation can only have limited impact. The text is replete with warnings and weak examples clearly prioritising tax competition, undermining the very idea of strong CFC rules.
Action 4: Interest deductibility	**"Develop recommendations (…) to prevent base erosion through the use of interest expense" (ie. related-party and third-party debt to achieve excessive interest deductions)**	
Deliverable: Common approach / best practice (Non-binding) ***Assessment:*** Below expectations ***Trade union relevance:*** Moderate	***Pros:*** A fixed ratio rule to limit an MNE entity's net deductions for interest payments to 10-30% of its EBITDA.	***Cons:*** The results are not binding, and the group ratio rule which was relegated to an ad hoc option would have made for a more effective solution.
Action 5: Harmful tax practices	**"Improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, (…) requiring substantial activity for any preferential regime" (incl. patent boxes)**	
Deliverable: Minimum standard (Binding) ***Assessment:*** Below expectations ***Trade union relevance:*** Moderate	***Pros:*** Mandatory exchange of information on tax rulings, and a modified "nexus" approach that makes the use of preferential regimes (e.g. patent boxes) conditional on substantial economic activity (e.g. effective R&D presence).	***Cons:*** The deliverable introduces minor tweaks at the cost of legitimising the entire concept of patent boxes and other preferential regimes, hence indirectly encouraging tax competition.
Action 6: Treaty abuse	**"prevent the granting of treaty benefits in inappropriate circumstances" (including treaty shopping leading to the proliferation of "empty shell" and "letter box" companies)**	
Deliverable: Minimum standard / revision of the OECD Model Convention (Binding) ***Assessment:*** Meeting expectations ***Trade union relevance:*** Moderate	***Pros:*** An amendment to the OECD Model Convention that includes a limitation-on-benefits (LOB) rule and a principal purpose test (PPT).	***Cons:*** The deliverable is still a work-in-progress regarding the financial sector, with uncertainty remaining over the treatment of the USD$24tn pension fund industry, the USD$20tn private fund business, etc. Effective implementation will depend on the success of the multilateral instrument (Action 15).

Action 7: Permanent establishment	**"prevent the artificial avoidance of PE status [for local subsidiaries of MNEs] including through the use of commissionaire arrangements and the specific activity exemptions (and) address related profit attribution issues"**	
Deliverable: Revision of the OECD Model Convention (Binding) ***Assessment:*** Below expectations ***Trade union relevance:*** Moderate	***Pros:*** More stringent rules that will limit the effectiveness of the most common methods used by MNEs to artificially avoid their PE status.	***Cons:*** The changes are not very ambitious (e.g. weak anti-fragmentation rule) and are not designed to deal with the much wider set of PE challenges related to the digital economy. The question of profit attribution to a PE remains unresolved.
Actions 8-10: Transfer pricing	**"Assure that transfer pricing outcomes [of intra-MNE group trade and transactions] are in line with value creation"**	
Deliverable: Revision of the OECD Transfer Pricing Guidelines (Binding) ***Assessment:*** Below expectations ***Trade union relevance:*** High	***Pros:*** A monumental revision of the TP Guidelines which will grant tax administrations significantly more leeway to ensure TP outcomes align with value creation.	***Cons:*** The revision comes at the cost of considerable complexity, the perennial problem with "comparables" is left unaddressed, and the uncompromising stance on the "arm's length" principle leaves no scope for a broader shift to unitary taxation of MNEs.
Action 11: Measuring & monitoring	**"Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor [the] impact of the actions taken to address BEPS on an ongoing basis"**	
Deliverable: Report ***Assessment:*** Meeting expectations ***Trade union relevance:*** Moderate	***Pros:*** An exhaustive overview of macro-level and firm-level data sources and methodologies, including a selection of 6+2 indicators to measure BEPS.	***Cons:*** Failure to recognise that the limitations pertaining to currently available data and the tools used to analyse them would most efficiently be addressed by making corporate tax reports and statistics publically available.
Action 12: Mandatory disclosure rules	**"recommendations regarding the design of mandatory disclosure rules" (legal requirements in a handful of OECD countries)**	
Deliverable: Common approach / best practice (Non-binding) ***Assessment:*** Below expectations ***Trade union relevance:*** Low	***Pros:*** A general but comprehensive manual on creating or improving MDRs.	***Cons:*** Failure to reach agreement on a binding minimum standard, and acknowledge the need for tax schemes to be disclosed at least to a selected group of stakeholders, if not publically.

Action 13: Transfer pricing documentation and country-by-country reporting	**"Develop rules regarding transfer pricing documentation"**	
Deliverable: Minimum standard (Binding) ***Assessment:*** Meeting expectations ***Trade union relevance:*** High	***Pros:*** A game-changing new standard for corporate tax transparency consisting of three tiers: Master file, Local file, and C-b-C reports.	***Cons:*** The C-b-C reports will not be disclosed to the public, reporting applies only to MNEs with annual revenue in excess of EUR€750m, and the concerns of emerging and developing countries were largely ignored.
Action 14: Dispute resolution mechanisms	**"address obstacles that prevent countries from solving treaty related disputes"**	
Deliverable: Minimum standard (Binding) ***Assessment:*** Meeting expectations ***Trade union relevance:*** Low	***Pros:*** Harmonised rules that should improve the speed with which disputes are resolved.	***Cons:*** A missed opportunity to significantly improve transparency and accountability in the area of dispute resolution.
Action 15: Multilateral instrument	**Develop a "multilateral instrument" that would simultaneously implement all of the BEPS treaty-related measures**	
Deliverable: Treaty (Binding) ***Assessment:*** N/A ***Trade union relevance:*** Low	***Pros:*** If successful, it would strengthen multilateralism in the global tax system. Over 90 countries – well beyond the OECD and G20 membership – are taking part in the negotiation process.	(Deliverable expected by the end of 2016.)

Relevance to trade unions

3. As shown in Table 1 above and in section III, not all of the 15 action points have the same level of importance for trade unions. Some are more relevant than others. BEPS Action Points that are highly relevant for trade unions:

- Actions 8-10 on Transfer Pricing (revision of the binding OECD Transfer Pricing Guidelines): Transfer pricing manipulation is the BEPS practice that trade unions should be most concerned with. It affects the distribution of profits within the MNE group, and provides a biased picture of the economic and financial performance of its individual entities.
- Action 13 on country-by-country reporting (binding minimum standards on transfer pricing documentation and country-by-country reporting): access to C-b-C reports and transfer pricing documentation is essential for workers and their representatives in order to have a full and comprehensive picture of where the sources of profits and assets are located within their MNE group.

4. Other BEPS Action Points that are relevant for trade union actions:

- Action 1 on the digital economy (report): The tax challenges exposed by the report are a manifestation of much broader policy challenges associated with the digital economy and the digitalisation of the economy. The tax arbitrage practices are likely to be replicated in other forms of regulatory arbitrage, including labour law (e.g. employing "independent contractors" for what are essentially wage-earner/salaried employee posts). This is why the follow up to Action 1 should be monitored closely.
- Action 4 on debt interest deductibility (non-binding rules and common approaches): excessive deduction of interest is a "classic" BEPS technique used to artificially reduce the profit levels of a subsidiary located in a regular tax jurisdiction.
- Action 5 on Harmful tax practices (binding minimum standard): The relocation of valuable intangible assets such as patents or IP rights abroad for the purpose of exploiting preferential regimes weakens the balance sheet of the subsidiaries where intangible assets were created and hence may threaten the long term sustainability of the company. Action 5 has direct implications on employer responsibilities.
- Action 6 on tax treaty abuse (binding minimum standard and revision of the OECD Model Convention): Treaty shopping has a direct impact on the level of complexity and opacity of MNE group structures. When combined with other BEPS practices, such as manipulation of transfer pricing, it can lead to a substantial diversion of assets and resources away from the balance sheets of economically relevant entities within the MNE group. Opacity of a group structure may also negatively impact workers' right to information and consultation where such is established by law or by collective agreement.
- Action 7 on Permanent establishment (Binding minimum standard and revision of the OECD Model Convention): When an MNE artificially fragments its local businesses into several separate entities in order to partially or fully avoid the PE status, it may negatively impact the profitability of the subsidiary, and with it workers' remuneration, non-wage benefits, the coverage and quality of the collective bargaining agreement, as well as information and consultation rights.
- Action 11 on measuring the BEPS impact (report): the 6 OECD indicators could be very useful to trade unions (and other stakeholders) for measuring and monitoring a given company's exposure to "tax risk".

5. Bearing this in mind, five steps are suggested for trade union engagement with MNEs regarding tax responsibility (covered in more detail in section IV):

1. Request access to C-b-C reports and other transfer pricing documentation;
2. Find ways around confidentiality requirements;
3. Request the OECD BEPS indicators to be integrated into the company's reporting framework;
4. Focus on specific transfer pricing risks; and
5. Keep an eye out for other BEPS practices.

Will it work?

6. It remains to be seen whether and to what degree the final outcome proves effective in preventing corporate tax avoidance. For the BEPS Monitoring Group – whose detailed

comments represented the most active and accomplished civil society voice throughout the whole BEPS public consultation process – although the BEPS package is overall a welcome improvement, it constitutes a patch up exercise designed to plug the biggest holes of what is ultimately an unwieldy, unfair, and unsustainable system.[ii] A number of shortcomings indeed suggest that optimism should be guarded:

- Failure to account for the unitary dimension of MNEs;
- Tax competition still seen as a virtue;
- Increased complexity of tax rules; and
- Overly strict adherence to business confidentiality.

Failure to account for the unitary dimension of MNEs

7. The crux of the tax avoidance problem lies with a flawed system in which, for tax purposes, subsidiaries of a single MNE group operating in different jurisdictions are treated as "independent entities". In order to prevent this legal fiction from leading to abuse, the system is governed by a complicated set of transfer pricing rules designed to ensure that subsidiaries use "arm's length" prices (market prices) when trading between each other. Hoping to impose and enforce the competitive market logic on entities that are in reality centrally controlled and working in unison for the benefit of their group's own interest is incredibly difficult, and has given rise to corporate tax avoidance on a mass scale. Yet it is precisely this system that the BEPS project has set out to rescue.

8. Trade unions and civil society organisations propose treating MNEs for what they are – unitary entities that should be subject to "unitary taxation" at a global level based on an agreed formula to divide the profits between countries.[iii] This could be done in several ways, from significantly expanding the profit split method to worldwide formulary apportionment, and could make for a simpler and fairer system with potentially far less opportunities for tax avoidance.

9. Indeed, some tentative advances towards such a new direction can already be glimpsed within the BEPS package. Whether it is country-by-country reporting, the new substance and nexus based transfer pricing provisions, the upcoming work on profit splits, CFC rules, or even the repressed group-wide ratio rule on limiting interest deductions, all these testify to the growing need for and creeping acceptance of treating MNEs as unitary entities, and represent important stepping stones towards a more substantial reform of the international tax system.

Tax competition still seen as a virtue

10. From the outset, the BEPS package kept its distance from the fundamental problem of "tax competition", with the OECD even broadly supportive of it. Tax competition puts pressure on jurisdictions to lower tax rates and to devise increasingly outlandish tax breaks and tax incentives in an attempt to attract multinational enterprises (MNEs), resulting in a race to the bottom that ultimately impoverishes the general public, while fostering an environment that is conducive to corporate tax avoidance. Until tax competition is recognised as a major part of the problem and begins to be treated that way, the impact of even the most ambitious solutions will be limited.

Increased complexity of tax rules

11. Complexity is what tax avoidance schemes live off and thrive in. The BEPS package will add hundreds of pages to domestic laws, tax treaties, guidelines, and toolkits that tax administrations, tax departments of MNEs, and other stakeholders will have to make sense of, and that the tax avoidance industry will do its utmost to exploit.

12. Transfer pricing rules, the review of which was central to a successful outcome of the BEPS project make for a telling example. The original OECD Guidelines on Transfer Pricing, already numbering 375 pages and accepting five different transfer pricing methods are set to grow in size by more than 50% and potentially more once the work on profit splits is completed. This is just one element of a system that is already highly complex.

13. Better quality for more complexity may sound like an acceptable trade, but more complexity equals higher compliance costs for MNEs and higher enforcement costs for tax administrations. As the latter are notoriously underfunded and lacking in expertise even in the developed world[iv], the trade-off may very well turn out to be better quality for lower enforcement capacity. OECD's faith in the arm's length principle hence delivers another heavy cost to stakeholders.

14. The ever-increasing complexity of rules, the level of jurisdictional cooperation already required to make them work, and the need for a coherent interplay between the many different deliverables of the BEPS package – hybrid mismatch arrangements, CFC rules, interest deduction limitations, harmful tax practices, treaty shopping and transfer pricing guidelines – come together as another stark reminder that treating MNEs as unitary actors has long ago become the simpler, more straightforward, and by far more effective way forward. The rapidly spreading digitalization of the economy, dematerialization of production, and other technological disruptions on the near horizon will necessitate even more complex tax rules under the current regime, further intensifying this pressure point.

Overly strict adherence to business confidentiality

15. The outcomes of the BEPS project have also been undermined by a rigid adherence to confidentiality between tax administrators on the one side, and corporate executives with their tax advisers on the other. The C-b-C reporting framework (BEPS Action 13) provides the most egregious example. There are no plans for public disclosure, and the OECD has made clear that it will not be up for discussion during the implementation phase. The logic of this limited transparency runs throughout the BEPS package.

16. The oft repeated claim that reducing business confidentiality in tax matters would jeopardise competitiveness is based on foundations which at best lie somewhere between vague and dubious. On the contrary, greater transparency has been shown to contribute to fair competition, not stifle it, unless the MNE in question is competing by way of a tax scheme that is. That is the view of civil society organisations[v], but also, and quite tellingly, the conclusion of a 2014 independent impact assessment produced by PwC for the European Commission[vi]. Tax related business confidentiality also weakens corporate accountability to stakeholders of the firm, including workers, long term investors and creditors, as well as the public at large. Some of the

most impactful work on corporate tax avoidance to date has been done by actors that have no direct access to the relevant data, and are instead forced to rely on their own investigative skills, or on embattled whistle-blowers. The most prominent example is the International Consortium of Investigative Journalists, a global network responsible for exposing the "Offshore Leaks", "Luxembourg Leaks", "Swiss Leaks", and most recently the "Panama Papers"[vii], but also NGOs like Oxfam, Christian Aid and ActionAid[viii], the responsible investment community[ix], and last but not least trade unions, which have begun integrating tax issues into their corporate accountability campaign[x]. These actors are almost solely responsible for generating the political will to address corporate tax avoidance, yet they continue to be kept out of the loop.

The implementation phase

17. The release of the final package does not mark the end of the process. Challenges arising out of the digital economy will continue to be monitored, and some deliverables will require further engagement and negotiations, notably the work on the application of the transactional profit split method and hard to value intangibles, rules for the attribution of profits in light of the changes to the PE status, the treatment of pension funds and sovereign wealth funds under the new LOB rule, treatment of the insurance and banking sectors vis-à-vis recommendations on interest deductions, and finally the multilateral instrument, to be ready by the end of 2016.

18. It is of utmost importance for these remaining negotiations to be transparent, taking on board the perspectives and inputs of developing countries in a serious and institutionalised manner. Aside from a number of regional consultations and network meetings, the BEPS project has been dominated by the 34 OECD member states, 2 countries in the accession process, and 8 G20 non-OECD members. These 44 were joined in early 2015 by a group of 14 developing countries, but they only had the status of invitees without any significant say in the proceedings, and were nevertheless invited only once work on most of the Actions was well on its way to be finalised. The pressure mounted in July 2015 at the Financing for Development Conference in Addis Ababa, where developing countries called for the creation of a more representative "intergovernmental tax body" under the auspices of the UN. Their request was denied, but it exposed the risk of growing divergence between OECD members and developing countries regarding the functioning of the international tax system. In response, the G20 Communiqué in Antalya came with a little surprise. The G20 Heads of State called "*on the OECD to develop an inclusive framework by early 2016 with the involvement of interested non-G20 countries and jurisdictions which commit to implement the BEPS project, including developing economies, on an equal footing*".[xi] This new inclusive framework was officially launched at a meeting of the OECD Committee on Fiscal Affairs held in Kyoto on 30 June 2016, bringing to 82 the number of jurisdictions committed to implement the BEPS package[xii].

19. The manner in which the BEPS package will be implemented is crucial. Implementation should be swift, and in order to get the most out of the package, countries should go beyond the mandatory minimum standards and adopt its non-mandatory provisions to the highest degree possible. The strength of the package is also directly proportionate to the number of jurisdictions it counts among its signatories. In this sense, much will depend on the multilateral instrument, as failure to reach an agreement here would unravel considerable progress, and likely draw out the implementation over several more years.

20. Last but not least, governments have to match their commitments to curb aggressive tax planning with increased resources for their already understaffed and underfinanced tax administrations, which will face even greater pressure under the new regulatory regime. Without a credible enforcement capacity, any system of rules is doomed to fail, no matter how well designed.

II. About base erosion and profit shifting

21. Before assessing the final package itself, it is necessary to understand the nature of the problem it aims to address. In this regard, a primary distinction needs to be made between tax evasion and tax avoidance (also known as aggressive tax planning). While tax evasion is clearly illegal, tax avoidance is typically considered to fall in the grey area of compliance. In the latter case, profits are not hidden from the tax authorities per se, they are recorded and declared, but they are artificially shifted in such a way so as to lower the overall effective tax rate of the MNE group, leading to the erosion of national tax bases.

The formation of the international tax system

22. The basic architecture of the international tax system that is still in use today dates back all the way to the 1920s. Generally, corporate income tax in most states was calculated as the product of the taxable base (usually the worldwide net profit of the company) multiplied by the tax rate set at the level of each individual country. This was a relatively simple formula to implement nationally, but when business activities turned international, it naturally led to clashes between jurisdictions about the allocation of rights to tax the profits of a company operating in two or more countries. Such conflicts about the differential treatment of companies by different jurisdictions threatened to result in international double taxation, so under pressures from the business community, solutions to this quandary were sought at the League of Nations.

23. After the early hopes for a comprehensive multilateral agreement to systematically allocate the jurisdiction to tax were extinguished due to irreconcilable differences between the leading powers, an alternative, loose, and increasingly complicated coordination system was pursued instead. As part of it, countries accepted certain limitations on their international ability to tax, and a network of bilateral tax treaties based on model conventions took off and proliferated. They were founded on an uneasy consensus established by the colonial powers, under which business profits of a company or permanent establishment could be taxed at source (the market of the final sale, where the profits were actually generated), while the returns on investment were primarily taxable by the country of residence (where the company was incorporated and its core functions, assets and risks supposedly resided).

24. The system of taxing rights was thus solidified in favour of residence taxation, overwhelmingly benefiting capital exporting countries (advanced economies) at the expense of capital importers (mostly developing countries). Due to the persistent asymmetry of power between these blocs, wealthy capital exporters were also able to negotiate numerous provisions into treaties, restricting the latter group's ability to defend their tax bases from abuse by

traditional means like profit taxes, capital gains taxes, or withholding taxes, adding more fuel to what has come to be known as the "source-residence conflict".

25. Because it would be difficult to treat an MNE with all its subsidiaries as a single entity without a great deal of multilateral cooperation, the situation was resolved by creating a parallel legal fiction called the "independent entity principle". Under this principle, even though MNEs with all their subsidiaries were in reality controlled centrally in every significant way, for tax purposes, each subsidiary of an MNE was to be treated as a unique individual entity.

26. This created a major problem. Trade and investment among related entities is natural and represents a major share of total trade and investment, but when these related entities are seen as wholly separate for tax purposes, it opens the possibility for an MNE group to artificially trade and invest in such a way as to shift all profits from every one of its subsidiaries to a tax haven, effectively avoiding being taxed at all. This potential loophole was foreseen and addressed by special rules on transfer pricing, set up to regulate the pricing of any goods, services, or capital flows that took place between related parties. The most important of these rules was another legal fiction called the "arm's length principle", which dictated that when related parties transact with each other, they have to behave as if they were trading with a non-related party, that is by using market prices.[xiii]

27. The basic structural pillars of the international tax system thus essentially amounted to a version of the honour system, backed up by a very complicated set of transfer pricing rules and guidelines designed to ensure that related parties arrive at the market price, or somewhere close enough. There was, however, an important external dimension that further exacerbated the weaknesses of this structure.

The rise of tax competition

28. While corporate tax avoidance is about as old as the corporate income tax itself, the sheer scale at which it is occurring today traces back to the neoliberal policy reforms of the 1970s and 1980s. With capital controls lifted, capital became hypermobile, and the concept of competition began its dogmatic transformation into a fundamentally positive phenomenon, a virtue that should be encouraged under any circumstances and in all areas, including the area of taxation.

29. This coincided with the proliferation of "offshore" tax havens. Tax havens were made more accessible than ever before, and considerably ramped up the competitive pressure on regular "onshore" jurisdictions.[xiv] With tax havens everywhere and tax competition legitimised and even extolled, tax rate shopping found a most permissive environment, forcing countries into a global race to the bottom which resulted in a secular decline in tax rates, and the proliferation of tax incentives and tax breaks at the expense of the general publics, especially those of developing countries.

30. Tax competition is often seen as a natural phenomenon that has to be accepted. But tax competition is far from inevitable. There are numerous precedents which show that bypassing the competitive logic and reaching some limited level of harmonisation, or at least a higher minimum standard in an area is possible, whether through unilateral or multilateral action. One

such example is the 1962 adoption of CFC rules by the USA. Initially, this seemed to put US MNEs at a competitive disadvantage, but eventually, 25 other countries followed – among them most of the G20 members – and CFC rules have now also been included in the BEPS package.

31. The OECD could play a tremendously positive role in tackling the problem of tax competition, and it came close to it some twenty years ago. In 1998 the OECD launched a landmark report on "harmful tax competition" that started this process off.[xv] The OECD's aim was to identify and dismantle various forms of tax abuse and to induce both its own members and non-member tax havens to adopt a common set of minimal standards, or be subject to "coordinated defensive measures". Both the idea of defensive measures and the mere suggestion that tax competition could in some circumstances be harmful eventually sparked a storm of controversy so furious that they were removed from all subsequent reports. Some officials at the OECD regretted ever using the phrase harmful tax competition: "*As an economist, how can you ever say anything bad about competition?*"[xvi] The OECD was forced to retreat and considerably scale down the ambitions of the project, with all written mentions of "harmful tax competition" downgraded to "harmful tax practices", a conceptual and linguistic stigma that appears to persist in official OECD documents to this day.[xvii]

The many faces of corporate tax avoidance

32. Aggressive tax planning schemes come in many shapes and forms. The techniques constantly adapt and evolve, kept up to date by the tax avoidance industry with whatever latest changes are taking place on the legislative front and in the wider global economy alike, tailored to fit the specific needs of their individual corporate clients.[xviii] Despite the enormous variety, most schemes typically fall into a more manageable number of categories. The OECD Action Plan on BEPS has been designed to address the most common ones, and in order to foster a better understanding of the solutions found in the final package of the project, this section contains simplified representations of these model schemes to illustrate how they work, and what factors need to be in place to make them function as intended. The following Figures are based on a joint ITUC and TUAC paper published in 2013.[xix]

Manipulating intra-group transfer pricing

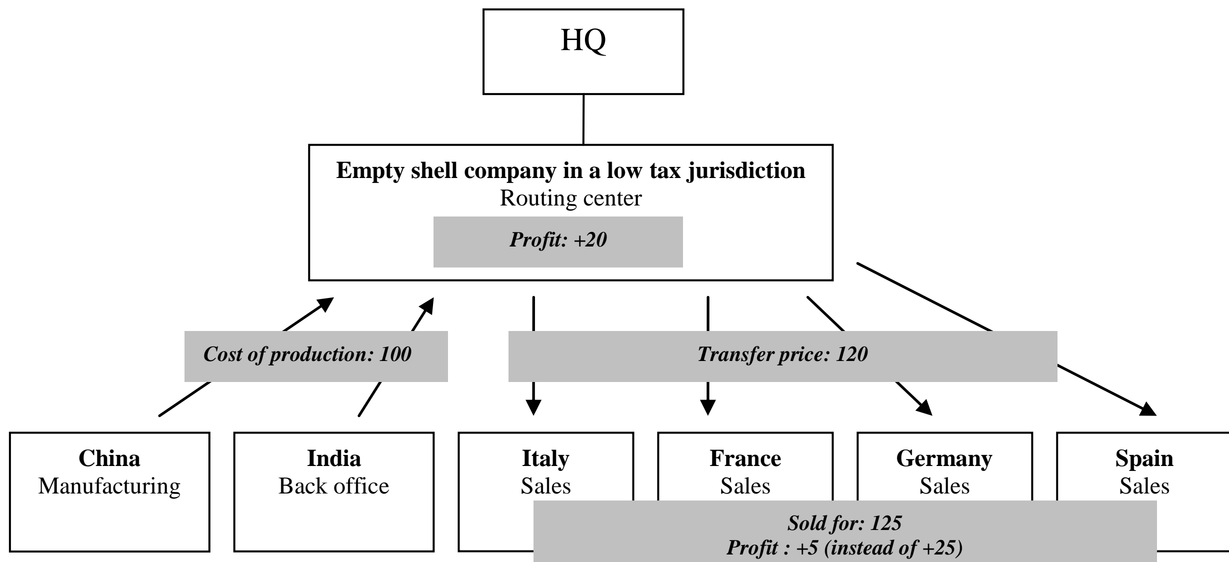
33. Transfer pricing manipulations are by far the most frequent method of tax avoidance, appearing as an important part of nearly every scheme at a certain point. As outlined in the previous section, unlike transactions between two truly independent MNEs, transactions between related subsidiaries within a single MNE can be distorted in such a way as to minimise profits in regular tax jurisdictions where sales to the final consumer typically occur, and maximise profits in low or zero tax jurisdictions.

34. The OECD Transfer Pricing Guidelines were designed to prevent such distortions by requiring MNEs to adhere to the arm's length principle. Central to the arm's length principle is the use of a "comparability analysis", which values transactions within an MNE with reference to the conditions that would apply to two independent MNEs undertaking "comparable transactions" under "comparable circumstances" in order to ensure that market prices are indeed used. However, perfect comparables are very often difficult to find, market prices can vary even

within a set of applicable comparables, and MNEs are generally afforded considerable discretion in choosing which comparables they apply, all of which can give rise to artificial profit shifting even when the rules are fully adhered to, as shown in Figures 1 and 2.

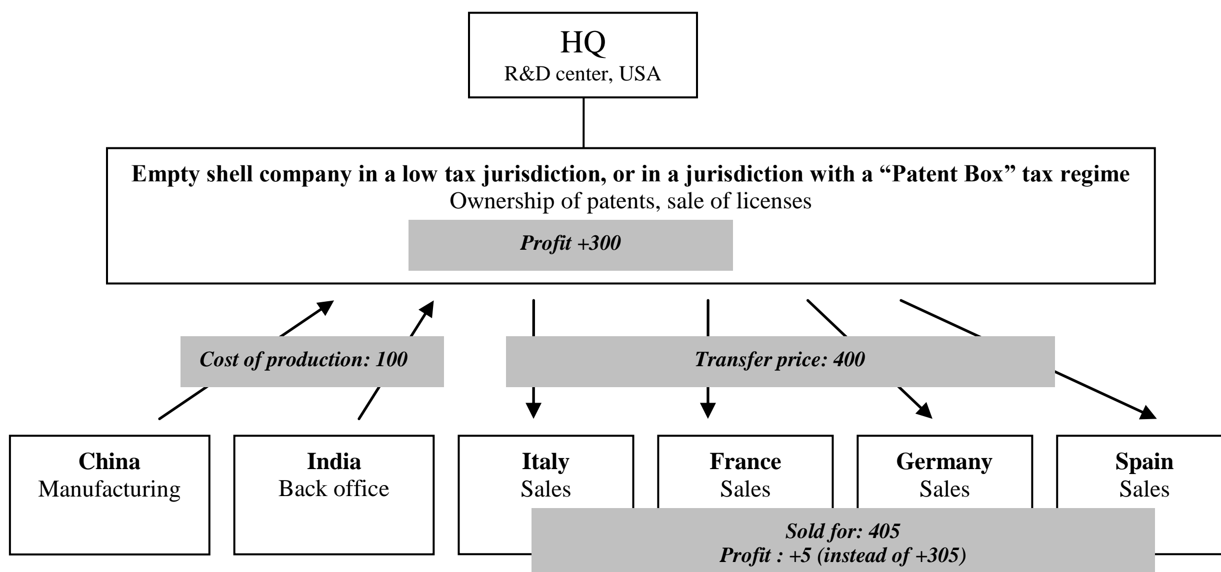
35. In Figure 1, the outputs of manufacturing and services located in China and India are to be sold in Europe. The straightforward way would have the European subsidiaries purchase the final products from the Chinese subsidiary for 100, and sell it in their respective markets for 125, generating a profit of 25. This would however mean that the entire profit from this venture would be taxed in the regular tax jurisdictions of Europe. To avoid this, the MNE can route the final products through a distribution centre located in a low or a zero tax jurisdiction, ensuring that a majority of the profits will be taxed at a much lower rate.

Figure 1: Manipulating transfer pricing



36. In Figure 2, such manipulation is even easier to pull off, because intellectual property very often lacks any comparables whatsoever, leaving it up to the MNE to price it nearly at will.

Figure 2: Manipulating transfer pricing (hard to value intangibles)

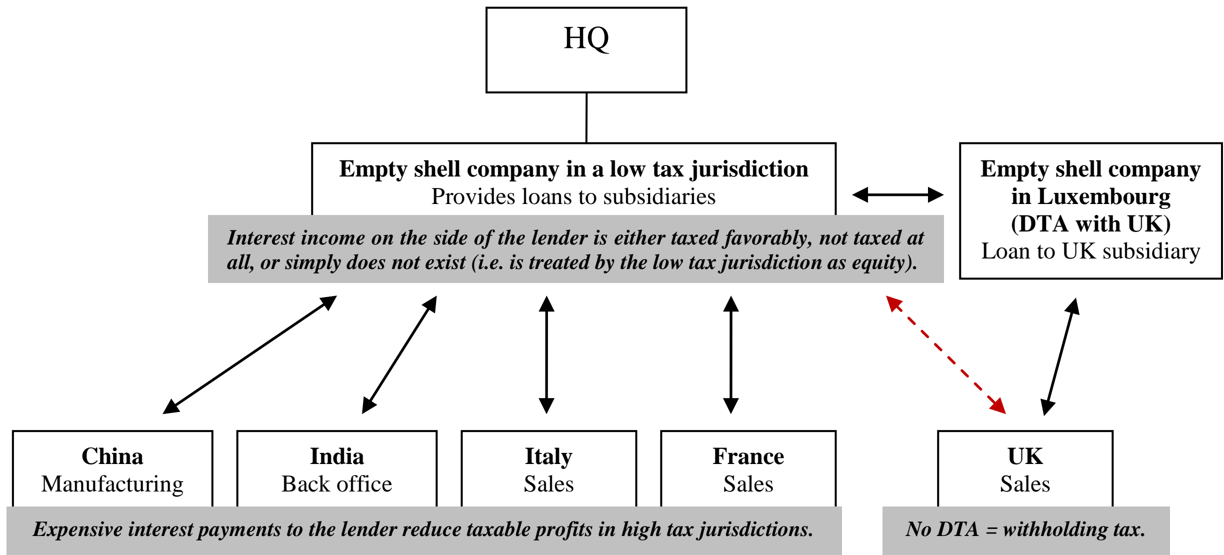


Exploiting interest deductibility and hybrid mismatches

37. Another key method of avoiding tax is the abuse of deductible payments for the purpose of reducing the taxable bases of profitable subsidiaries located in regular tax jurisdictions. Such payments can be wholly artificial, i.e. pursued without any commercial rationale other than avoiding tax, they can be excessive, i.e. pursued with an actual commercial rationale but overpriced in order to avoid tax, or a combination of both. A classic example is outlined in Figure 3, where an MNE artificially shifts debt through a subsidiary in a low or zero tax jurisdiction by expensively lending to its subsidiaries in regular tax jurisdictions. Interest payments made by the newly debt-laden subsidiaries lower their taxable profits, while the corresponding interest income on the side of the lender is either taxed favourably, not taxed at all, or simply does not exist. The last scenario can arise in a situation involving a so called hybrid mismatch, which occurs for example when the same source of financing product – in this case the loan – is treated as debt in the jurisdiction of the borrower, but as equity in the jurisdiction of the lender.

38. The problem of abusing deductible payments is not limited to traditional debt servicing. Other forms of financial transfers like intra-group insurance, guarantees on commercial and credit default risk, or internal derivatives used in intra-bank dealings can likewise give rise to similar base erosion processes. Abusive deductions can also be sought vis-à-vis costs which are not based on financial instruments, such as royalties and management fees.

Figure 3: Interest deductibility, hybrid mismatches and treaty shopping



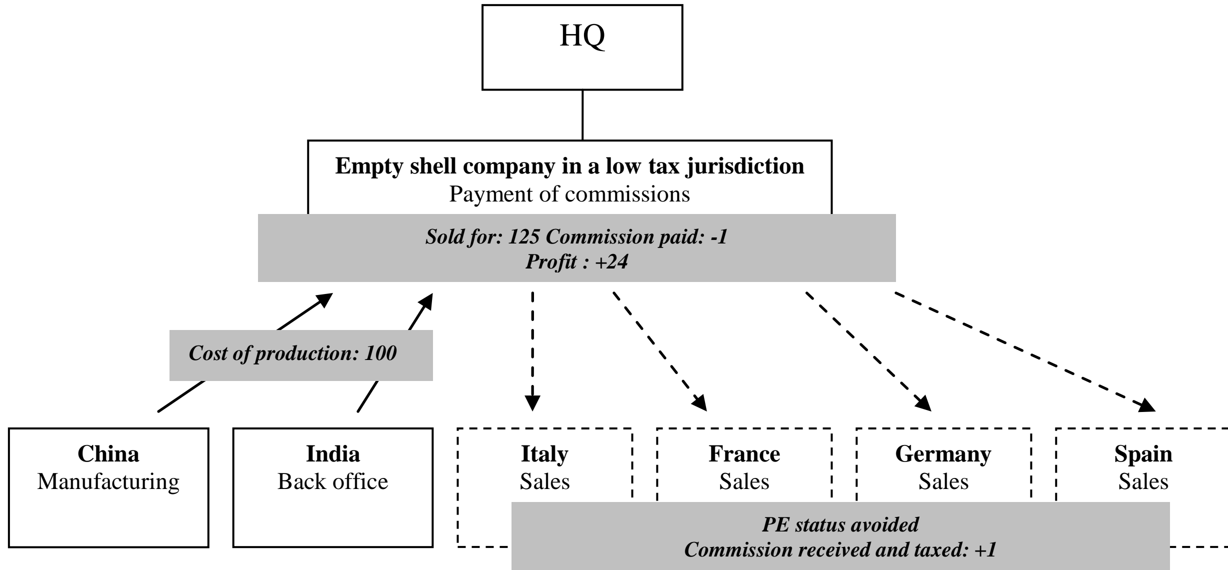
Treaty shopping

39. Remaining within the world of Figure 3, it may happen that some of the host jurisdictions of the subsidiaries from which an MNE wishes to siphon off profits through interest payments will not have a Double Taxation Agreement (DTA) with the country of the lending subsidiary, as is the case with UK in this example. This could pose a problem, because without a DTA, the lending subsidiary would be subject to a UK withholding tax on the incoming interest payments sent by the UK subsidiary that might render the scheme unprofitable. There is an easy way out however. All the original lender needs to do is to route the loan through another jurisdiction that does have a DTA with the UK. In this case, Luxembourg fits the bill perfectly, because under its DTA with the UK, interest payments to Luxembourg are not subject to UK withholding tax, and Luxembourg itself does not levy any withholding tax on the original lender either.

Avoiding the permanent establishment status

40. Another way to avoid tax is to artificially avoid the taxable presence of a subsidiary altogether. This can be done in a number of ways, but a typical case, shown in Figure 4, is to use a so called “commissionaire arrangement”, whereby an entity sells products in a jurisdiction in its own name, but on behalf of a foreign MNE that owns these products. This enables the foreign MNE to avoid the PE status in a given jurisdiction, meaning it also avoids being taxed there. Because the entity conducting the sales does not own the products that it sells, it cannot be taxed on the profits derived from the sales of these products either. Hence, the only taxation incurred is on the “commission” the selling entity receives from the foreign MNE in exchange for its services.

Figure 4: Avoiding the permanent establishment status



Harmful tax practices

41. Finally but perhaps most importantly comes the issue of harmful tax practices, the OECD's euphemism for what is essentially tax competition, but significantly narrowed down to cover only a handful of the most egregious preferential regimes. A closer look at Figures 1-4 illustrates just how indispensable tax competition is to any tax avoidance scheme. Regardless of the method used, tax avoidance is overwhelmingly about shifting profits into low or zero tax jurisdictions and losses into regular tax jurisdictions, so most schemes hinge on huge differences between tax rates around the world. Alternatively, countries can retain regular tax rates, but still get to join the competitive fray through lax defensive or enforcement standards, by offering an endless array of preferential tax regimes, tax incentives, tax breaks, or secretive tax rulings, any of which can further be tailored to a specific sector, activity, or even an individual MNE, as the "Luxembourg Leaks" scandal can attest to.

Measuring the impact

42. The impacts of base erosion resulting from corporate tax avoidance are difficult to measure, but according to available empirical analyses they are significant, far reaching not only materially but also behaviourally, and have been continuing on a growing trajectory.

43. The most direct and tangible impact is obviously on tax revenues. As the primary source of public funding, tax revenues are essential to the entire macroeconomic system. Tax avoidance leads to significant tax revenue losses, contributing to the reductions in spending on vital public services (healthcare, education, social security, public transportation, etc.), infrastructure, investment, emergencies (natural disasters, management of financial crises, etc.), and other priorities including transitioning to a green economy, integration of refugees and migrants, or provision of development aid, all of which already face severe strains due to austerity cuts.

According to OECD estimates released as part of Action 11 of the final BEPS package, revenue losses from aggressive tax planning are conservatively estimated to be in the range of USD$100-240 billion annually, or 4-10% of the global corporate income tax base, with the effects higher in developing countries due to their greater reliance on corporate income tax revenues.

44. But there are other system-wide impacts:

- Impact on market competition: MNEs that engage in aggressive tax planning gain unfair advantages over MNEs that refrain from such practices, as well as over domestic-only enterprises. This increases their market power, leading to concentrated markets, lowering innovation, and resulting in significant consumer welfare losses. According to the OECD, the effective tax rates paid by large MNE entities are estimated to be 4 to 8.5% lower than similar domestic-only enterprises.

- Impact on allocation of debt: aggressive tax planning artificially reduces the cost of debt, and creates incentives for excessive leveraging and misallocation of debt within MNE groups. According to the OECD, the interest-to-income ratio for affiliates of the largest global MNEs in regular tax countries are almost three times higher than their MNE's worldwide third-party interest-to-income ratio.

- Impact on tax competition: Aggressive tax planning and tax competition are in a circular relationship of mutual reinforcement, with demand for one strengthening demand for the other, and vice versa, leading to lower tax rates and more regressive tax mixes. According to the OECD, the profit rates reported by MNE affiliates located countries with lower tax rates are on average twice as high as their group's worldwide profit rate. Furthermore, the ratio of the value of royalties received to spending on research and development (R&D) in a group of low tax countries was six times higher than the average ratio for all other countries, increasing three-fold between 2009 and 2012.

- Impact on tax morale and rule of law: real or perceived acceptance of aggressive tax planning may contribute to a broader institutional environment that is conducive to lower tax compliance, weak rule of law, corruption, organised crime, and even human rights abuses.[xx]

- Impact on inequality: aggressive tax planning naturally increases inequality as it is almost exclusively available to actors that are already well off, and makes tax systems more regressive as it hits the revenues of what is one of the most progressive forms of taxation – the corporate income tax.

45. The impacts are also company-specific:

- Impact on government relations and litigation: public outrage has forced governments into a more active role regarding aggressive tax planning, so companies engaging in such behaviour risk legal fees, penalties, and the loss of lucrative government contracts.
- Impact on corporate governance, accountability, and allocation of capital: investors rely on sound corporate accountability at every step of the investment chain. Aggressive tax

planning tends to correlate with higher levels of opacity throughout the organisation, markedly reducing the agency of institutional investors. Opacity often also leads to further corporate governance abuses, and can be conducive to inefficient investment decisions, excessive shareholder and executive remuneration, and short-termist thinking.

Why it matters for workers

46. A central technique used by MNEs for avoiding their tax obligations is to elaborate formal corporate structures in which the allocation of functions to the various entities of the MNE is fragmented in a way that does not reflect the distribution of economic risks and added-value within the MNE group. When tax-motivated restructuring leads to the fragmentation of a company into numerous separate entities, the access of workers to decision making centres is reduced, because these are transferred outside the legal perimeter of the local company to a holding company established in a foreign jurisdiction. The subsequent artificial shifting of profits from the local company negatively affects its profit levels and thereby its ability to invest in productive capacities, or even to face its liabilities. This also affects the fair distribution of wealth generated by the company, for instance by undermining employee profit-sharing agreements.

47. More broadly, aggressive tax planning is just another form of corporate "regulatory planning" or regulatory arbitrage that advances a short-termist agenda. When an MNE escapes its obligations to the tax collector, its obligations to other stakeholders, including workers, are also often at risk. Trade union experience strongly suggests that tax liability issues are intertwined with employer responsibility issues. A trade unionist of the French subsidiary of Colgate perfectly captured why tax planning matters for trade union action: "*the farther you are from where tax is being declared within the MNE group structure, the higher the risk for worker misery*".[xxi]

48. Knowledge about tax planning practices is therefore crucial and should become an integral part of a trade unionist's toolbox. Trade unions and other bodies of representation such as works councils should allocate considerable resources for legal and tax expertise to anticipate the consequences of legal restructurings, be their impacts financial, social or governance related.

III. TUAC assessment of the BEPS package

49. The original G20 mandate for the BEPS Action Plan and the project's primary objective was to reform existing international tax rules in a way that would align them with the rapid changes taking place within an increasingly globalised economy, and ensure that MNEs were taxed "*where economic activities take place and value is created*".[xxii] The final package offers:

- 1 revision of the OECD Transfer Pricing Guidelines (Actions 8-10) and the OECD Model Tax Convention on the permanent establishment status (Action 7);
- 4 new legally binding "minimum standards" designed to address harmful tax practices (Action 5), treaty shopping (Action 6), introduce a game-changing new country-by-

country (C-b-C) reporting framework (Action 13), and an improved dispute resolution mechanism (DRM) (Action 14);

- 4 broadly agreed but non-binding "common approaches" and "best practices" addressing hybrid mismatch arrangements (Action 2), controlled foreign company (CFC) rules (Action 3), manipulations involving interest deductions (Action 4), and mandatory disclosure rules for abusive transactions, arrangements, or structures (Action 12);
- 2 in-depth reports on the digital economy (Action 1) and on measuring and monitoring BEPS (Action 11); and
- 1 new multilateral instrument, to be negotiated and finalised by the end of 2016, that aims to simultaneously implement all of the BEPS treaty-related measures (Actions 2,6,7 & 14) into existing bilateral tax treaties in one fell swoop (Action 15).

50. Assessing the results of the BEPS package necessarily depends on the starting position of the assessor, the benchmark of comparison. The first option would consist of determining whether the objectives have been met by comparing the final version of the BEPS package with the state of affairs that preceded it, the status quo ante. The second option would be to determine whether the objectives have been met by comparing the final version of the BEPS package with what could have reasonably been achieved given the constraints imposed by the mandate, the options that were on the negotiating table, as well as broader political and economic realities. Finally, the third option would compare that which has been achieved with that which ought to have been achieved to effectively eliminate BEPS practices. This assessment has predominantly been conducted using the second approach, which we believe to be the most fair and appropriate one in this situation, but certain sections of the final package have necessitated a limited use of the remaining approaches as well.

51. Given the multifaceted systemic impact of corporate tax avoidance on the well-being of societies, the BEPS project as a whole is highly relevant to trade unions. However, when looking at the individual deliverables and narrowing the scope down to the dimensions of MNE employer responsibilities and trade union interests – e.g. impact on wages and social benefits, access to collective bargaining, long term sustainability of the company including employment prospects, as well as other priorities like workers' pension funds investment policies – not all of the action points bear the same level of relevance. Some will have a greater and more direct impact on the rights and well-being of workers than others. Accordingly, a part of this assessment focuses on weighing the implications of the BEPS deliverables from the vantage point of these dimensions.

52. Three levels of relevance are used to that end:

- Low relevance: the deliverable has little impact on the employer responsibilities of the MNE and/or on trade union bargaining power;
- Moderate relevance: the deliverable might not have a direct impact, but is part of a broader set of management practices related to BEPS that can affect employer responsibilities and/or trade union bargaining power;
- High relevance: the deliverable has a direct impact and hence should be treated as a priority by trade unions.

Action 1 – Address the Tax Challenges of the Digital Economy

<table>
<tr><td colspan="3">“Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties”</td></tr>
<tr><td>Deliverable: Report / recommendation on VAT/GST (Non-binding)
Assessment: Meeting expectations</td><td>Pros
A comprehensive rundown of challenges arising from the digital economy.</td><td>Cons
Stops short of more ambitious recommendations that were on the negotiating table, such as a new digital PE status.</td></tr>
<tr><td>Relevance to trade unions: Moderate</td><td colspan="2">The tax challenges exposed by the OECD report on the digital economy are a manifestation of much broader policy challenges. The business model of fully digitalised operations and the increasing digitalisation of economies do not fit the traditional producer (value creation) – consumer (user) model upon which the entire regulatory framework and not just taxation, but also competition, labour, financial market. Accordingly the tax arbitrage practices are likely to be replicated in other forms of regulatory arbitrage, including labour law (e.g. employing “independent contractors” for what are essentially wage-earner/salaried employee posts). This is why the follow up to Action 1 should be monitored closely.</td></tr>
</table>

53. The focus of Action 1 was to identify the difficulties that the digital economy poses for a meaningful application of existing international tax rules, and to develop detailed options to address them. Because the digital economy is increasingly becoming the economy itself, it was deemed to be impractical if not impossible to ring-fence it from the rest of the economy for tax purposes. Some of the most important features of this sector found to exacerbate BEPS risks include mobility, reliance on data, network effects, and the spread of multi-sided business models, such as several varieties of e-commerce, app stores, online advertising, cloud computing, participative networked platforms, high speed trading, and online payment services.

54. In the area of direct taxation, the challenges have been identified as relating to three broad categories: nexus, data, and characterisation.

- Nexus pertains to the already reduced and continuously decreasing need of these actors for physical presence in jurisdictions where they conduct business activities, combined with the network effects generated by customer interactions. Take Amazon as an example. Should operating a warehouse in a country be reason enough to constitute a permanent establishment and thus a taxable presence there? Normally this would not be the case, but speedy delivery is a major component of Amazon’s business model and by itself generates considerable value for the company. Or when customers freely leave product reviews on Amazon’s website and thus increase its overall value – which is directly monetised by the owners through advertising revenues – which jurisdiction should that value be attributed to and how should it be taxed?

- Data pertains to the fair attribution of value generated by the increasing use of intangible products and services. Increasing number of businesses rely on data collection and leveraging to create value that is eventually monetised with considerable gains. How should data be treated for tax purposes? How should valuation and ownership be determined, when value and subsequent monetisation are sometimes generated out of personal data that under the laws of numerous jurisdictions are a property of the individual and thus not assets of the company? Should remote or location-specific data collection constitute a taxable presence even in the absence of a physical presence?

- Characterisation pertains to payments made in the context of new business models, particularly in relation to cloud computing. Should infrastructure-as-a-service, software-as-a-service, or platform-as-a-service types of transactions be considered as royalties, fees for technical services, or business profits? Currently, these types of transactions are treated very differently and rather arbitrarily under most tax treaties, but the digital economy markedly expands this grey zone, increasing the pressure to find a solution.

55. The questions raised above represent a mere tip of the iceberg of those covered in the Action 1 report, but rather than tackling these challenges head on, they were deemed to be better served indirectly for the time being by new provisions under Action 3 (recommendations to changes in CFC rules that would make certain incomes typical to the digital economy taxable in the jurisdiction of the ultimate parent company); Action 7 (modifications to the definition of permanent establishment and to the list of exceptions to this definition); Action 8 (revisions to the transfer pricing of intangibles); and more broadly also by Actions 4, 5, and 6.

56. A total of five concrete options were on the table and seriously discussed during the negotiation process:

- The option to modify the exceptions to the permanent establishment status in order to ensure that they are available only for activities that are in fact preparatory or auxiliary in nature (more in Action 7);
- A new nexus approach, which would basically create a new permanent establishment status based on new criteria of what constitutes significant economic presence;
- A withholding tax on certain types of digital transactions;
- An equalisation levy that could serve as an alternative way to tax a non-resident enterprise's significant economic presence in a country; and
- The collection of VAT/GST on cross-border transactions.

57. Unfortunately, what was adopted was only a rather unambitious interpretation of option 1 and a recommendation for option 5. The former basically representing the lowest common denominator position of the lot, the latter concerned with regressive consumption taxes that are known to place a greater relative burden on lower income households. The remaining options, either of which would have raised the bar more notably in terms of making sure large MNEs pay their share where they operate, were not pursued.

58. Overall, the one area that has been tackled in a more straightforward fashion in Action 1 has been that of indirect taxation (option 5). The problem identified was that of lacking or inappropriately low collection of value added taxes and goods and services taxes (VAT/GST), especially on cross-border transactions between businesses (e.g. Amazon, eBay, Alibaba) and consumers, adversely affecting countries' VAT/GST revenues and the level playing field between resident and non-resident vendors. Countries are recommended to apply the principles of the International VAT/GST Guidelines and consider introducing the collection mechanisms included therein.

TUAC assessment of Action 1

59. Action 1 has been largely exploratory and has in many ways been left open due to the rapid changes taking place within the digital economy and its spread to more traditional sectors. The outlined issues will be subject to continued monitoring and analysis, with follow-up work to be conducted based on the findings of a report to be produced by 2020.

60. While Action 1 inspires little action as such, it is not without achievements. It opens the door and lays down comprehensive foundations for what is likely to be a debate necessitating a monumental transformation of international tax rules. Its detailed coverage of tax challenges and questions stemming from the digital economy outline an increasingly widespread and imminent reality that will only grow to clash with existing international tax rules if the principle of "*taxing profits in the jurisdiction where they arose*" is to be meaningfully adhered to or indeed make any discernible sense whatsoever.

61. The issues exposed in Action 1 strongly suggest that the very same fundamental tenets and principles that the OECD has stood by and set out to rescue in the BEPS package – e.g. the controversial asymmetry between source and residence taxation, the independent entity principle, and the arm's length principle – will have to be re-examined. The OECD is not blind to these developments, and to their credit, Action 1 contains numerous sections that suggest that some re-evaluation of these traditional principles will be required.

Relevance to trade unions: moderate

62. The tax challenges exposed by the OECD report on the digital economy are a manifestation of much broader policy challenges. The business model of fully digitalised operations and the increasing digitalisation of economies do not fit the traditional producer (value creation) – consumer (user) model upon which the entire regulatory framework and not just taxation, but also competition, labour, financial market. Accordingly the tax arbitrage practices are likely to be replicated in other forms of regulatory arbitrage, including labour law (e.g. employing "independent contractors" for what are essentially wage-earner/salaried employee posts). This is why the follow up to Action 1 should be monitored closely.

Action 2 – Neutralizing the Effects of Hybrid Mismatch Arrangements

"Design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities" (e.g. treated as debt in one jurisdiction, as equity in another)		
Deliverable: Common approach / best practice (Non-binding) ***Assessment:*** Below expectations	**Pros** Covers a broad set of hybrid arrangements in a technically sophisticated manner.	**Cons** It comes at the cost of complexity and is not binding. It will require jurisdictional cooperation that may not be forthcoming in a global environment where tax competition is still considered a virtue.
Relevance to trade unions: Low		

63. The focus of Action 2 was to develop a common approach that would inhibit the misuse of hybrid entities and instruments (e.g. treated as debt in one jurisdiction, as equity in another) which result in substantial erosion of countries' taxable bases.

64. The recommendations set forth require changes both to domestic laws and to the OECD Model Tax Convention. They consist of automatically applied linking rules that align the tax treatment of an entity or an instrument with that of all participating jurisdictions, outlining a specific order in which actions are to be taken. So for instance, the first jurisdiction would have the right to deny a deduction to a taxpayer if the payment concerned was not taxed by the second jurisdiction. Should the first jurisdiction for whatever reason fail to act in preventing the misuse of a hybrid entity or instrument, the second jurisdiction will have the right to apply a defensive measure, either by including the above deduction to income and taxing it, or denying a duplicate deduction, depending on the nature of the mismatch.

65. If applied, the measures should prevent this type of double non-taxation by eliminating the tax benefits of mismatches, i.e. by putting an end to multiple deductions for a single expense (double dipping), deductions in one country without corresponding taxation in another, and the generation of multiple foreign tax credits for a single amount of foreign tax paid.

TUAC assessment of Action 2

66. The sheer number of hybrid arrangements dealt with is proof enough that a tremendous amount of work has gone into Action 2. What is more, the recommendations appear to be as technically sophisticated as they are complex and broad in scope, and given enough cooperation between jurisdictions, have the potential to succeed in their task. Unfortunately, two concerns sully this well-deserved praise.

67. First, the recommendations are just that. Although the measures have been specifically designed to be used independently by jurisdictions, a high degree of inter-jurisdictional cooperation – which does not necessarily exist – will be needed for the recommendations to be implemented. One of the problems with hybrid mismatches is that they are difficult to detect, because the laws of all participating jurisdictions are actually being followed when looked at individually. Signatories of the BEPS package have pledged to move in the general direction outlined by the recommendations, but speed and diligence with which they go about it, or indeed in which they are actually able to go about it – whether in terms of resources, political contingencies, or different legal traditions – is left entirely up to them. Given the rampant tax competition that even a number of major powers participating in the BEPS project frequently engage in, it is not inconceivable that some jurisdictions – third country or otherwise – may aim to position themselves as "competitive" by *de facto* allowing some of these arrangements to continue functioning.

68. The second concern is complexity, the breeding ground of tax avoidance. Even in the best case scenario of responsible, well resourced, and fully cooperating jurisdictions, we may hope to neutralise only the specific hybrid arrangements covered in Action 2 and those similar to them. However, considering the pace of "financial innovation" – the highly complex instruments

designed by the financial sector more broadly and the shadow banking sector particularly – it is more than likely that arrangements of a different nature will quickly sprout in their place.

Action 3 – Designing Effective Controlled Foreign Company Rules

"Develop recommendations regarding the design of controlled foreign company rules" (including taxation of non-resident subsidiaries, partnerships, trusts, or other entities conveniently based in low or zero tax jurisdictions)		
Deliverable: Common approach / best practice (Non-binding) ***Assessment:*** Below expectations	**Pros** Comprehensive set of rules for countries to consider and choose from.	**Cons** It is not binding, and without substantial cooperation can only have limited impact. The text is replete with warnings and weak examples clearly prioritising tax competition, undermining the very idea of strong CFC rules.
Relevance to trade unions: Low		

69. The focus of Action 3 was to provide countries interested in developing new (or improving existing) controlled foreign company (CFC) rules a set of flexible recommendations on how to proceed. The building blocks for effective CFC rules have been identified as: a) definition of a CFC; b) CFC exemptions and threshold requirements; c) definition of income; d) computation of income; e) attribution of income; and f) prevention and elimination of double taxation.

70. Strong CFC rules are an important deterrent component of any anti-tax avoidance toolbox. They can go a long way towards curbing artificial profit shifting or long-term deferral of taxation to non-resident subsidiaries, partnerships, trusts, or other entities conveniently based in low or zero tax jurisdictions, which are however for all intents and purposes controlled from the original country of residence. CFC rules are also important because when specific conditions are met, they essentially override the independent entity principle, and can also bring some balance to the historical asymmetry between source and residence taxation.

TUAC assessment of Action 3

71. The OECD came up with a relatively exhaustive set of rules for countries to consider, but if CFC rules are to be effective, they require even higher levels of cooperation and coordination than the measures against hybrid mismatches. This fact does not appear to be recognised in the text, which instead provides just another broad set of recommendations that countries get to pick and choose from at will. Worse still, the very document that offers these recommendations is also flooded with warnings about the need to strike a careful balance between tax competitiveness and tax revenues, and urges countries to stay on the safe side of tax competitiveness, undermining the very idea of strong CFC rules.

72. This logic is evident throughout Action 3, with the standards that appear in the explanations and examples provided being set at staggeringly conservative levels. One such example is the discussion about what tax rate should apply to CFC income, where a lowly 12% top-up tax is suggested. CFC rules thus come out looking like an afterthought the adoption of

which should be carefully considered, and could very well turn out to jeopardise countries' competitive positions.

Action 4 – Limiting Base Erosion Involving Interest Deductions & Other Financial Payments

"Develop recommendations (…) to prevent base erosion through the use of interest expense" (ie. related-party and third-party debt to achieve excessive interest deductions)"		
Deliverable: Common approach / best practice (Non-binding) ***Assessment:*** Below expectations	**Pros** A fixed ratio rule to limit an MNE entity's net deductions for interest payments to 10-30% of its EBITDA.	**Cons** The results are not binding, and the group ratio rule which was relegated to an ad hoc option would have made for a more effective solution.
Relevance to trade unions: *Moderate*	Excessive deduction of interest is a "classic" BEPS technique used to artificially reduce the profit levels of a subsidiary located in a regular tax jurisdiction. To the extent that profit levels have impact on the long term sustainability of the company, including employment prospects, Action 4 has direct implications on employer responsibilities.	

73. The focus of Action 4 was to limit the extent to which MNEs can lower their overall tax obligations by manipulating third party and intra-group financing, or to put it another way, to ensure that the net interest deductions of MNEs are directly linked to the taxable income generated by their economic activities.

74. Three typical scenarios of such base eroding planning have been identified as: a) MNEs shifting higher levels of third party debt to high tax jurisdictions; b) MNEs using intra-group loans to generate interest deductions in excess of the group's actual third party interest expense; and c) MNEs using third party or intra-group financing to fund the generation of tax exempt income.

75. After analysing several best practices, the OECD ended up recommending a fixed ratio rule which limits an entity's net deductions for interest and interest-like payments to somewhere between 10-30% of its earnings before interest, taxes, depreciation and amortisation (EBITDA). In the cases of MNEs that are highly leveraged due to non-tax reasons, a group ratio rule can be used alongside the fixed ratio rule. Special rules for the banking and insurance sectors are to be elaborated by the end of 2016.

TUAC assessment of Action 4

76. Action 4 is another case of a final version being significantly watered down when compared with the content and language of the discussion draft that preceded it.

77. While the independent entity principle is, as discussed, a problematic concept per se, its use is particularly inappropriate when dealing with such highly centralised functions of an MNE as its financing arrangements. This reality was openly recognised in the discussion draft, according to which "*group-wide tests in theory have the greatest potential to tackle base erosion and profit shifting using interest*".[xxiii] Put in other words, the best way to treat interest-related BEPS risks is on a unitary basis, apportioning interest deduction limits according to an

appropriate allocation key reflecting the economic reality of the business group. Fixed ratio rules that remain faithful to the independent entity principle were also considered, but as was rightly pointed out in the discussion draft itself, a fixed cap would be a blunt tool that does not take into account the sometimes vastly different leverage ratios between sectors, not to mention individual MNEs, many of which happen to be active in several different sectors.

78. In the final version, the fixed ratio rule nevertheless prevailed, and what could have been a more effective way to ensure that on aggregate an MNE's interest deductions would not surpass its consolidated interest costs to third parties, has been relegated to an ad hoc option to be used only in specific circumstances. Not only that, disallowed interest that fell afoul of the 10-30% corridor is allowed to be carried forward or carried back. This means that a tax scheming MNE would not actually have to give up any of its ill gotten gains, it would merely have to redistribute them more evenly across periods. With the recommendations being non-binding, and the range of options in which they can be applied cast so wide, Action 4 is not meeting initial expectations.

Relevance to trade unions: moderate

79. Excessive deduction of interest is a "classic" BEPS technique used to artificially reduce the profit levels of a subsidiary located in a regular tax jurisdiction. To the extent that profit levels have impact on the long term sustainability of the company, including employment prospects, Action 4 has direct implications on employer responsibilities.

Action 5 – Countering Harmful Tax Practices More Effectively

"Improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, (…) requiring substantial activity for any preferential regime" (incl. patent boxes)		
	Pros	**Cons**
Deliverable: Minimum standard (Binding) ***Assessment:*** Below expectations	Mandatory exchange of information on tax rulings, and a modified "nexus" approach that makes the use of preferential regimes (e.g. patent boxes) conditional on substantial economic activity (e.g. effective R&D presence).	The deliverable introduces minor tweaks at the cost of legitimising the entire concept of patent boxes and other preferential regimes, hence indirectly encouraging tax competition.
***Relevance to trade unions**: Moderate*	The relocation of valuable intangible assets such as patents or IP rights abroad for the purpose of exploiting preferential regimes weakens the balance sheet of the subsidiaries where intangible assets were created and hence may threaten the long term sustainability of the company. Action 5 has direct implications on employer responsibilities.	

80. The focus of Action 5 was to address harmful tax practices by strengthening the criteria for assessing preferential regimes, and improving the standards on transparency and exchange of information between jurisdictions.

81. Regarding preferential regimes, Action 5 mandates that they be assessed based on a new strengthened substantial activity requirement, a "nexus approach" that should ensure that a taxpayer benefits from a regime only to the extent that it incurs the expenditures which the

regime was designed to attract, so for instance only if it invests enough into R&D in the jurisdiction from which it derives its IP regime benefits.

82. In terms of transparency, countries have agreed on a new framework for mandatory spontaneous exchange of information on rulings that could give rise to BEPS concerns, covering six categories: a) rulings related to preferential regimes; b) cross-border unilateral advance pricing arrangements (APAs) or other unilateral transfer pricing rulings; c) rulings giving a downward adjustment to profits; d) permanent establishment rulings; e) conduit rulings; and f) any other type of ruling that might give rise to BEPS concerns.

83. The solutions outlined constitute a minimum standard that all BEPS package signatories have committed themselves to implement, and work will continue under the existing Forum on Harmful Tax Practices (FHTP) to reassess old preferential regimes with the new requirement, review new preferential regimes, and engage with non-signatory third parties to ensure that harmful tax practices are not merely shifted to these other jurisdictions.

TUAC assessment of Action 5

84. Of the 43 preferential regimes assessed by the FHTP, 18 were deemed "*not harmful*" or "*potentially harmful but not actually harmful*", with 4 still "*under review*". To the OECD's credit, all 16 IP regimes have been found to be inconsistent with the new nexus approach and are being phased out. However, this does not mean competing via IP regimes is a thing of the past. Ever the frontrunner, Ireland has already launched the first ever BEPS-compliant IP regime – the Knowledge Development Box – which offers a 6.25% tax rate on profits arising from R&D activities carried out in Ireland.[xxiv] Other competitors are certain to follow, and that goes as much for IP regimes as for non-IP regimes. The modified nexus approach thus succeeded in tweaking only the most outrageous aspects of IP boxes, while legitimising the concept of competing in this way. Given the difficulty of defining what constitutes R&D activities and which factors within the R&D process play the most value generating role, it is difficult to imagine how the modified nexus approach can put a stop to aggressive tax planning by the likes of Apple or Google.

85. The framework for mandatory spontaneous exchange of information on rulings is comprehensive in scope and very welcome, though its effectiveness would be substantially improved if the rulings had to be disclosed publically. Ultimately it is the publics that bear the brunt of potential beggar-thy-neighbour policies, so it is not only their right to know, but such increased oversight would likely serve as a more powerful deterrent to rulings that could turn out to be harmful. The findings of the EU's illegal state aid investigations following the "Luxembourg Leaks" revelations clearly show that such oversight is needed.[xxv]

Relevance to trade unions: moderate

86. The relocation of valuable intangible assets such as patents or IP rights abroad for the purpose of exploiting preferential regimes weakens the balance sheet of the subsidiaries where intangible assets were created and hence may threaten the long term sustainability of the company. Action 5 has direct implications on employer responsibilities.

Action 6 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

“prevent the granting of treaty benefits in inappropriate circumstances” (including treaty shopping leading to the proliferation of “empty shell” and “letter box” companies)		
Deliverable: Minimum standard / revision of the OECD Model Convention (Binding) ***Assessment:*** Meeting expectations	**Pros** An amendment to the OECD Model Convention that includes a limitation-on-benefits (LOB) rule and a principal purpose test (PPT).	**Cons** The deliverable is still a work-in-progress regarding the financial sector, with uncertainty remaining over the treatment of the USD$24tn pension fund industry, the USD$20tn private fund business, etc. Effective implementation will depend on the success of the multilateral instrument (Action 15).
***Relevance to trade union**: Moderate*	Treaty shopping has a direct impact on the level of complexity and opacity of MNE group structures and consequently has direct relevance for trade union action. When combined with other BEPS practices, such as manipulation of transfer pricing, it can lead to a substantial diversion of assets and resources away from the balance sheets of economically relevant entities within the MNE group. Opacity of a group structure may also negatively impact workers’ right to information and consultation where such is established by law or by collective agreement.	

87. The focus of Action 6 was to prevent treaty shopping and other types of treaty abuse, which broadly arise when treaty benefits are granted in situations in which they were not intended to be granted, or to parties that were not intended to be covered. Treaty shopping leads to the proliferation of “empty shell” and “letter box” companies – legal entities with no economic justification other than to benefit from a given treaty benefit – and hence to overly complex and opaque MNE group structures.

88. Action 6 comes in the form of a minimum standard, and the outlined approach consists of three measures: a) specific changes to the wording of the OECD Model Tax Convention which clarify that tax treaties are not intended to be used to generate double non-taxation; b) an introduction of a flexible limitation-on-benefits (LOB) rule that specifies the conditions under which an entity can be granted treaty benefits; and c) a more general anti-abuse rule called the principal purpose test (PPT), which determines whether a given transaction or arrangement has been made in accordance with the intended aims of the treaty provisions, or principally for the purpose of securing a treaty benefit, in which case the benefit will be denied. Countries have a choice in how they implement the LOB and PPT rules. They can apply: a) a combined approach of an LOB and PPT rule; b) the PPT rule alone; or c) the LOB rule supplemented by a mechanism that would deal with conduit financing arrangements not already dealt with in tax treaties.

89. Action 6 also contains a number of clarifications to improve the interactions between treaty provisions and domestic anti-abuse rules, and provides a list of policy considerations that developing countries should heed, especially when entering into treaty obligations with low or zero tax jurisdictions.

90. Outstanding work remains on determining how the proposed LOB rule affects access to treaty benefits for collective investment vehicles like pension funds, and non-collective investment vehicles like private equity funds, hedge funds, and derivatives. Both categories

should be dealt with by the end of 2016, and while pension funds are naturally of particular concern to workers, it is the treatment of the latter category that will be crucial for the success of Action 6. Indeed, the financial sector appears to be especially prone to aggressive tax planning, and due to its inherent complexity holds unique challenges that have yet to be resolved.

TUAC assessment of Action 6

91. Overall, the deliverable on action 6 meets the initial mandate of the 2013 BEPS Action Plan, but opportunities for a better agreement were missed. Countries participating in the negotiations failed to reach a consensus about whether an LOB or a PPT rule would be more appropriate in combating treaty abuse, and indeed even about what minimal standard would constitute an effective LOB rule. The BEPS Monitoring Group also suggested that a stronger message would have been sent with a substantive article in treaties declaring that the object and purpose of a treaty is to ensure that profits are taxed where economic activities occur and value is created.[xxvi] While this suggestion was simple to implement, fully in line with the BEPS mandate and helpful with regard to possible future legal challenges, it was not taken on board.

Relevance to trade unions: moderate

92. Treaty shopping has a direct impact on the level of complexity and opacity of MNE group structures and consequently has direct relevance for trade union action. When combined with other BEPS practices, such as manipulation of transfer pricing, it can lead to a substantial diversion of assets and resources away from the balance sheets of economically relevant entities within the MNE group. Opacity of a group structure may also negatively impact workers' right to information and consultation where such is established by law or by collective agreement.

Action 7 – Preventing the Artificial Avoidance of Permanent Establishment Status

"prevent the artificial avoidance of PE status [for local subsidiaries of MNEs] including through the use of commissionaire arrangements and the specific activity exemptions (and) address related profit attribution issues"		
Deliverable: Revision of the OECD Model Convention (Binding) ***Assessment:*** Below expectations	**Pros** More stringent rules that will limit the effectiveness of the most common methods used by MNEs to artificially avoid their PE status.	**Cons** The changes are not very ambitious (e.g. weak anti-fragmentation rule) and are not designed to deal with the much wider set of PE challenges related to the digital economy. The question of profit attribution to a PE, which was part of the initial mandate, remains unresolved.
Trade union relevance: Moderate to high	Artificial avoidance of the PE status has a direct impact on workers. When an MNE artificially fragments its local businesses into several separate entities in order to partially or fully avoid the PE status, it may negatively impact the profitability of the subsidiary, and with it workers' remuneration, non-wage benefits, the coverage and quality of the collective bargaining agreement, as well as information and consultation rights.	

93. The focus of Action 7 was to prevent the use of certain common strategies that artificially enable the foreign subsidiaries of MNEs to avoid the permanent establishment status, which according to most tax treaties exempts their local business profits from any taxation whatsoever.

94. The OECD has broadly clustered the variety of abusive strategies under two categories: a) commissionaire arrangements; and b) exploitation of exceptions to the permanent establishment status. In the first scenario, MNEs have been using third parties to sell on their behalf, which technically enabled them to avoid the permanent establishment status. In the second scenario, the exceptions were meant to pertain to activities and assets of a preparatory or auxiliary nature only, but MNEs have found a way to abuse these provisions by fragmenting cohesive businesses into smaller operations and arguing that each part is merely engaged in preparatory or auxiliary activities. This enabled them to artificially benefit from the exceptions, and thus avoid the permanent establishment status. This latter category of abuse faces further complications with the rapid rise and spread of the digital economy, because many activities that legitimately used to be preparatory or auxiliary under older business models now correspond to core business activities in the new ones.

95. The proposed countermeasures come in the form of changes to the wording and definitions in relevant articles and paragraphs of the OECD Model Tax Convention, as well as the addition of a new anti-fragmentation rule, which should make both clusters of strategies defunct.

TUAC assessment of Action 7

96. The proposed anti-fragmentation rule covers only certain kinds of sales-related preparatory and auxiliary activities, which are themselves not clearly delineated, leaving MNEs free to pursue fragmentation in the numerous areas untouched by these changes. These areas are far from insignificant however, as they include production, R&D, design, and other high value activities that constitute the sources of the greatest BEPS concerns today and increasingly tomorrow. For instance, Amazon's warehouses might now constitute a permanent establishment as speedy delivery is a core function of the brand, but the rules do not deal with sales of immaterial products or services. As the BEPS Monitoring Group aptly pointed out, it would mean that tangible products like paper books and DVDs are caught in the net, but electronic books and streaming services are not.[xxvii]

97. The question of attribution of profits to a permanent establishment is also yet to be dealt with under Action 7. This issue is likely to be taken up together with the outstanding work on profit splits as part of the amendments to transfer pricing guidelines, and will be important to follow with regards to the debate on source and residence taxation.

Relevance to trade unions: moderate to high

98. Artificial avoidance of the PE status has a direct impact on workers. When an MNE artificially fragments its local businesses into several separate entities in order to partially or fully avoid the PE status, it may negatively impact the profitability of the subsidiary, and with it

workers' remuneration, non-wage benefits, the coverage and quality of the collective bargaining agreement, as well as information and consultation rights.

Actions 8-10 – Aligning Transfer Pricing Outcomes with Value Creation

"Assure that transfer pricing outcomes [of intra-MNE group trade and transactions] are in line with value creation"		
	Pros	**Cons**
Deliverable: Revision of the OECD Transfer Pricing Guidelines (Binding) ***Assessment:*** Below expectations	A monumental revision of the TP Guidelines which will grant tax administrations significantly more leeway to ensure TP outcomes align with value creation.	The revision comes at the cost of considerable complexity, the perennial problem with "comparables" is left unaddressed, and the uncompromising stance on the "arm's length" principle leaves no scope for a broader shift to unitary taxation of MNEs.
Trade union relevance: High	Transfer pricing manipulation is the BEPS practice that trade unions should be most concerned with. It affects the distribution of profits within the MNE group, and provides a biased picture of the economic and financial performance of its individual entities. It is often combined with treaty shopping (Action 6) and excessive use of interest deductions (Action 4).	

99. Transfer pricing – with its cornerstone independent entity and arm's length principles – represents a fundamental building block of the international tax system. Actions 8-10 have thus naturally been the most anticipated and widely commented on out of the entire BEPS package, as it was correctly recognised that changes in this area may have far reaching consequences for the transformation of the entire system. Indeed, while the OECD rejected work on any system based on formulary apportionment (unitary taxation) outright, in the BEPS Action Plan they did specify that "*special measures, either within or beyond the arm's length principle, may be required with respect to intangible assets, risk and over-capitalization to address these flaws*".[xxviii]

100. In the final version, the OECD concluded that going beyond the arm's length principle was not needed, as changes in the following areas can adequately meet the goals that have been set.

- Action 8 contains revised guidelines that deal with the misallocation of profits generated by intangibles and hard-to-value intangibles.
- Action 9 develops rules to prevent misaligning the contractual allocations of risk with the profits that should in substance correspond to those risks, and also tackles the transfer pricing misuse of so called "cash boxes" – capital-rich subsidiaries that in reality bear no risks themselves, but accrue disproportionate profits, all the while operating from low or zero tax jurisdictions.
- Action 10 focuses its guideline revisions on the remaining areas identified as high-risk: profit allocations that result from artificial transactions which would not be commercially rational other than for lowering the tax obligations of the whole group; other methods that divert profits from the economic activities most responsible for generating them; and neutralising the use of certain types of payments commonly used for BEPS purposes like management fees and head office expenses.

101. The Actions also contain updates to the application of existing pricing methods, with follow-up work commencing in 2016 on the profit split method, which has in certain circumstances been deemed more effective in aligning transfer pricing outcomes with value creation.

TUAC assessment of Actions 8-10

102. On the positive side, Actions 8-10 can be seen as an implicit admission that the independent entity principle is increasingly unworkable in an ever-growing number of cases, as seen in the recognition that "*legal ownership alone does not necessarily generate a right to all (or indeed any) of the return that is generated by the exploitation of the intangible*". Appropriate returns should accrue to all group companies based on the actual value of their contribution to the overall operation, regardless of where a high value asset (IP right, patent, etc.) may formally be registered. Risks, cash boxes, and other high risk areas covered under Actions 8-10 are treated similarly, which significantly expands the range of cases that are allowed to be re-characterised, i.e. adjusted by the tax administration if it can show that a transaction has been artificially under-priced or overpriced. Regarding the upcoming work on profit splits, it remains to be seen whether it could prepare the ground for a possible future shift towards unitary taxation. Continuing pressure and campaigning will be vital to help make this become reality, given the strong and explicit opposition of the OECD to any such notions at this time.

103. The downside of this more substance-oriented transfer pricing analysis is, as ever, much greater complexity, which is set to increase enforcement and compliance costs. Furthermore, the Actions have not addressed a key issue that the transfer pricing system has been struggling with since its inception – the chronic lack of comparables. So while the new approach has commendably granted tax authorities more leeway in challenging MNEs, making a case for re-characterisation that sticks is just as expensive, time consuming, and technically complicated as it ever was.

104. Last but not least, the whole process of determining transfer prices and challenging them if they are believed to fall afoul of the arm's length principle is essentially discretionary from the vantage point of both MNEs and tax administrations. The results may hence reflect the bargaining power of an individual MNE vis-à-vis a given tax administration rather than lead to a fair and objective assessment, resulting in a system that is not exactly close to being a level playing field. Combined with the practice of rulings and advance pricing arrangements, it could well leave open a vast space ripe for abuse by jurisdictions looking for a competitive advantage.

Relevance to trade unions: high

105. Transfer pricing manipulation is the BEPS practice that trade unions should be most concerned with. It affects the distribution of profits within the MNE group, and provides a biased picture of the economic and financial performance of its individual entities. It is often combined with treaty shopping (Action 6) and excessive use of interest deductions (Action 4).

Action 11 – Measuring and Monitoring BEPS

<table>
<tr><td colspan="3">“Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor [the] impact of the actions taken to address BEPS on an ongoing basis”</td></tr>
<tr><td>Deliverable: Report
Assessment: Meeting expectations</td><td>Pros
An exhaustive overview of macro-level and firm-level data sources and methodologies, including a selection of 6+2 indicators to measure BEPS.</td><td>Cons
Failure to recognise that the limitations pertaining to currently available data and the tools used to analyse them would most efficiently be addressed by making corporate tax reports and statistics publically available.</td></tr>
<tr><td>Trade union relevance: Moderate</td><td colspan="2">The OECD indicators could be very useful to trade unions (and other stakeholders) for measuring and monitoring a given company’s exposure to “tax risk”.</td></tr>
</table>

106. The focus of Action 11 was to improve the tools, methodologies, and data necessary to accurately measure and monitor BEPS, and to propose ways to evaluate the impact of the deliverables developed as part of the project. The OECD has identified six quantitative indicators to measure the extent and impact of aggressive tax planning for which data is currently available, and two additional indicators for which data is not necessarily available but should be collected in the future.

What to measure	OECD indicator	Data
A. Disconnect between financial and real economic activities	1. Concentration of high levels of foreign direct investment (FDI) relative to GDP	macro-level
B. Profit rate differentials within top (e.g. top 250) global MNEs	2. Differential profit rates compared to effective tax rates 3. Differential profit rates between low-tax locations and worldwide MNE operations	firm-level firm-level
C. MNE vs. “comparable” non-MNE effective tax rate differentials	4. Effective tax rates of large MNE affiliates relative to non-MNE entities with similar characteristics	firm-level
D. Profit shifting through intangibles	5. Concentration of high levels of royalty receipts relative to R&D spending	macro-level
E. Profit shifting through interest	6. Interest expense to income ratios of MNE affiliates in high-tax locations	firm-level
Future indicators	#. Profit rates compared to effective tax rates for MNE domestic (hq) & foreign operations #. Differential rates of return on FDI investment related to special purpose entities (SPEs)	firm-level macro-level

TUAC assessment of Action 11

107. Action 11 does not enjoy the same level of visibility in the public as the other action points, but it may well turn out to have deeper implications and greater impact than many of them in the longer term. It provides an exhaustive analytical overview of both existing and future data sources and methodologies, enriched by sober assessments of their limitations. In addition to the “6+2 indicators”, the deliverable includes specific recommendations on improving the collection, compilation and analysis of data, highlighting the need for governments to collaborate with academics and researchers within tax administrations, tax policy offices, and national statistical offices.

108. This leads to the report's most prominent shortcoming – the failure to acknowledge the need for data to be available publically. Whether it is data collection problems, limitations of currently available data, or issues with the tools used to analyse them, all these would in large part be resolved had the OECD agreed at least on a public disclosure of C-b-C reports (see Action 13 below), if not a broader set of corporate tax reports and statistics. The OECD also reaffirms its preference for regressive consumption taxes as outlined in the 2009 edition of its "Going for Growth" series and a number of subsequent publications. Corporate income taxes, we are told, "*entail distortions and have been found to be more harmful for economic growth compared to other taxes at least at their observed level*".[xxix] This narrow and rather simplistic interpretation is unfortunate on its own, but also because it falls outside the mandate of Action 11.

Relevance to trade union: moderate

109. The OECD indicators could be very useful to trade unions (and other stakeholders) for measuring and monitoring a given company's exposure to "tax risk".

Action 12 – Mandatory Disclosure Rules

"recommendations regarding the design of mandatory disclosure rules" (legal requirements in a handful of OECD countries)		
Deliverable: Common approach / best practice (Non-binding) ***Assessment:*** Below expectations	**Pros** A general but comprehensive manual on creating or improving MDRs.	**Cons** Failure to reach agreement on a binding minimum standard, and acknowledge the need for tax schemes to be disclosed at least to a selected group of stakeholders, if not publically.
Trade union relevance: Low		

110. The focus of Action 12 was to provide recommendations on best practices regarding the design of new (and improvement of existing) mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures. These legal requirements, which are in place only in a handful of OECD countries, oblige promoters of such schemes, their users, or both, to disclose them to the relevant tax authorities. The recommended design features cover both domestic schemes and the more complicated international ones, and are hoped to lead to enhanced models of information sharing between tax administrations.

TUAC assessment of Action 12

111. Mandatory disclosure regimes serve as an effective deterrent, as many taxpayers tend to think twice about entering into a scheme that has to be disclosed and that tax authorities may take an unfavourable view of. They are also helpful in identifying areas of risk within a tax system, and are generally a useful instrument of tax enforcement. While written in general terms to ensure flexibility, the recommendations on the relevant thresholds, hallmarks, and filters should succeed in covering most structures and schemes – if they are adopted that is.

112. The Action 12 deliverable is non-binding, marking it as yet another area in which jurisdictions could comparatively improve their competitive position through a mere lack of action. Another disappointing aspect is that transparency for the OECD once again ends at the doors of tax administrations. Since aggressive tax schemes can have a severely detrimental impact on a company's workforce as well as society at large, at the very least they should be disclosed to carefully selected stakeholders like company-level trade union representatives, if not outright provided publically at least in some form to facilitate independent evaluation of such taxpayer conduct.

Action 13 – Transfer Pricing Documentation and Country-by-Country Reporting

"Develop rules regarding transfer pricing documentation"		
Deliverable: Minimum standard (Binding) ***Assessment:*** Meeting expectations	**Pros** A game-changing new standard for corporate tax transparency consisting of three tiers: Master file, Local file, and C-b-C reports.	**Cons** The C-b-C reports will not be disclosed to the public, reporting applies only to MNEs with annual revenue in excess of EUR€750m, and the concerns of emerging and developing countries were largely ignored.
Relevance to trade union: High	Access to C-b-C reports and transfer pricing documentation is essential for workers and their representatives in order to have a full and comprehensive picture of where the sources of profits and assets are located within their MNE group.	

113. The focus of Action 13 was to develop rules regarding transfer pricing documentation that would balance the needs of tax administrations for greater transparency with compliance costs that would be acceptable for businesses.

114. The OECD proposal comes in the form of a minimum standard, and consists of a three-tiered approach to transfer pricing documentation requiring MNEs to submit the following documents:

- A "master file", requiring MNEs to provide all relevant tax administrations with high-level information regarding their global business operations and transfer pricing policies;
- A "local file", specific to each country, requiring detailed transactional transfer pricing documentation, identifying material related party transactions, the amounts involved in those transactions, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions; and
- A Country-by-Country (C-b-C) report, requiring all MNEs with annual consolidated group revenue equal to or exceeding EUR€750 million to provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax, and income tax paid and accrued. It will also require MNEs to report their number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction. Finally, it will require MNEs to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities each entity engages in.

TUAC assessment of Action 13

115. Compared with the transfer pricing documentation requirements of the pre-BEPS era – limited, general, and overly concerned with lessening the compliance burden of business – the comprehensiveness of the new reporting framework with standardised items for all jurisdictions is a welcome and indeed a key achievement of the BEPS project. Until now, even many G20 jurisdictions did not require any such reporting on a regular mandatory basis.

116. Unfortunately, as is the case with a number of other BEPS action points, the final agreement is noticeably weaker compared with what was on the table during the discussions. For example, emerging market countries requested additional transactional data beyond those appearing in the master file and the local file, such as related party interest payments, royalty payments, and especially related party service fees. These would be of particular use also to developing countries, which find it extremely challenging to obtain information on the global operations of an MNE group headquartered elsewhere. Regarding C-b-C reporting, the EUR€750 million threshold is unnecessarily high, allowing a huge number of MNEs to fly under the radar, depriving especially developing countries of crucial information needed to address their BEPS concerns.

117. Another concern lies with the way C-b-C reporting is to be filed. According to the final report, this should take place "*in the jurisdiction of tax residence of the ultimate parent entity and shared between jurisdictions through automatic exchange of information, pursuant to government-to-government mechanisms such as the multilateral Convention on Mutual Administrative Assistance in Tax Matters, bilateral tax treaties or tax information exchange agreements (TIEAs). In limited circumstances, secondary mechanisms, including local filing can be used as a backup*."[xxx] This will present an unnecessary obstacle to tax administrations in developing countries, which often do not enjoy the same networks and level of access to bilateral tax treaties and TIEAs as their OECD counterparts.

118. Finally and most disappointingly, public disclosure of C-b-C reports, even of a partial nature, was rejected from the beginning. It was in fact never even discussed during the negotiations. As was elaborated earlier, this restrictive approach to corporate tax accountability will not help rebuild citizen trust in global businesses and their fair contributions to economic development.

119. Despite these imperfections, C-b-C reporting is the most exciting measure of the entire BEPS package. It is set to become an unrivalled source of information for countries in order to assess BEPS risks and react accordingly to ensure MNEs are taxed where their economic activities take place and value is created.

Relevance to trade unions: high

120. Access to C-b-C reports and transfer pricing documentation is essential for workers and their representatives in order to have a full and comprehensive picture of where the sources of profits and assets are located within their MNE group.

Action 14 – Making Dispute Resolution Mechanisms More Effective

"address obstacles that prevent countries from solving treaty related disputes"		
Deliverable: Minimum standard (Binding) ***Assessment:*** Meeting expectations	**Pros** Harmonised rules that should improve the speed with which disputes are resolved.	**Cons** A missed opportunity to significantly improve transparency and accountability in the area of dispute resolution.
Trade union relevance: Low		

121. The focus of Action 14 was on improving dispute resolution mechanisms in order to minimise the risks of uncertainty and double taxation that may arise from the numerous changes adopted as part of the BEPS package.

122. As the OECD's own statistics show, the number of open mutual agreement procedure (MAP) cases in 2013 was 4566, 12.1% higher than in 2012, and 94.1% higher than in 2006.[xxxi] Given the number of novel rules set down by the BEPS package that will have to be interpreted and applied, the number of cases is only set to increase. Indeed, the very inclusion of Action 14 into the package can perhaps be seen as tacit acknowledgement of this likelihood.

123. The deliverable comes in the form of a minimum standard, with countries agreeing to strengthen the effectiveness and efficiency of the MAP found in the OECD Model Tax Convention, implement the agreed administrative processes, and ensure that taxpayers can access the MAP when eligible. Additionally, twenty countries have also declared their commitment to provide for mandatory binding MAP arbitration.

TUAC assessment of Action 14

124. Ensuring that the BEPS Action Plan would deliver effective dispute resolution mechanisms was part of a *quid pro quo* with business groups who feared that the BEPS package deliverables would lead to an increase in tax disputes and double taxation. Indeed, dispute resolution mechanisms are an important component of a functioning international tax system. Just as it is vital to resolutely address tax avoidance in all its forms, the risk of double taxation is also a legitimate concern that needs to be addressed. The rules of an effective system should however be designed in a way that minimises the need for such recourse in the first place, and resolves disputes in a principled, fair, and consistent manner when they arise. The current arrangement needs improvements on both counts. The central issue with dispute resolution is that the system almost exclusively consists of closed door proceedings and confidential verdicts passed down by arbitrators that can in many instances be seen to hold a conflict of interest.

125. The best way to improve the existing system of dispute resolution is by increasing transparency and accountability. For the BEPS Monitoring Group, a principled, fair, and consistent dispute resolution mechanism system will be difficult to achieve without proceedings that are open and transparent to the public, and verdicts that are rigorously argued and open to outside scrutiny for other taxpayers to learn from and act upon.[xxxii]

Action 15 – Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

Develop a "multilateral instrument" that would simultaneously implement all of the BEPS treaty-related measures		
Deliverable: Treaty (Binding) ***Assessment:*** N/A	**Pros** If successful, it would strengthen multilateralism in the global tax system. Over 90 countries – well beyond the OECD and G20 membership – are taking part in the negotiation process.	**Cons** (Deliverable expected by the end of 2016.)
***Relevance to trade union**:* Low		

126. The focus of Action 15 was to explore the technical feasibility of creating a multilateral instrument that would simultaneously implement all of the BEPS treaty-related measures (Actions 2, 6, 7 & 14) by amending all bilateral tax treaties of the signatory jurisdictions at once. This would avoid the burdensome alternative of having each signatory to the BEPS project individually renegotiating what in total numbers thousands of bilateral tax treaties. It concludes that a multilateral instrument is desirable and feasible, and a mandate has been developed for an ad-hoc group, open to the participation of all countries, to develop the multilateral instrument and open it for signature by the end of 2016. So far, more than 90 countries are participating in the work on an equal footing.

TUAC assessment of Action 15

127. While there is little to assess at the moment since work on the multilateral instrument is still ongoing, the rationale behind the idea is sound and fully supported. Aside from the obvious benefits, widespread adoption of the instrument would also prove that effective multilateral action is indeed possible in the area of international taxation, potentially paving the way towards even more ambitious outcomes in any future negotiations.

IV. What to request from MNEs

128. Information on corporate taxation and on the employer's tax liability matters to workers and their representatives. They matter to trade unions which are engaged in a collective bargaining process and/or when seeking information on the future strategy and business plans of the MNE group and/or its subsidiaries. As shown in the previous chapter, not all of the 15 actions points of the BEPS package have the same level of importance for trade unions. Some are more relevant than others. Bearing this in mind, the following five steps are suggested for trade union engagement with MNEs regarding tax responsibility.

Request access to C-b-C reports and transfer pricing documentation

129. All MNEs with annual consolidated group revenue equal to or exceeding EUR€750 million should deliver C-b-C reports to tax authorities. Trade unions should request access to

these reports because the information contained in them is highly relevant for a full and comprehensive picture of the MNE and any associated risk factors.

Other than C-b-C reports, trade unions should also ask for the two transfer pricing documents that MNEs are to provide to tax administrations:

- The “master file”, containing high-level information regarding their global business operations and transfer pricing policies; and
- The “local file”, containing detailed and specific information on the subsidiary and its relationship with the rest of the MNE group.

Find ways around confidentiality requirements

130. C-b-C reports and transfer pricing documents are bound by confidentiality. Yet the information contained in them does not threaten the right to business confidentiality or exposure of trade secrets. Trade unions should continue to campaign for public disclosure. At company-level, and in the absence of mandatory public reporting, there are ways around the confidentiality requirements. A good example can be found in the French legislation on works councils, which allows for the appointment of certified accountants bound by confidentiality to whom the company management can safely transmit any data it deems as too sensitive to be disclosed publically.

Request reporting on the OECD BEPS indicators

131. Company level information on the OECD indicators (Action 11) can help measure the overall level of engagement in aggressive tax planning by the MNE. Trade unions should request the company to report annually on the 6 firm-level OECD indicators, that is:

- Differential profit rates compared to effective tax rates;
- Differential profit rates between low-tax locations and worldwide MNE operations;
- Effective tax rates of large MNE affiliates relative to non-MNE entities with similar characteristics;
- Interest expense to income ratios of MNE affiliates in high-tax locations; and
- Profit rates compared to effective tax rates for MNE domestic (hq) & foreign operations.

Focus on specific transfer pricing risks

132. Transfer pricing is the principal method by which BEPS practices occur. All transactions within an MNE group may be subject to manipulation, but some categories of transaction and contractual arrangements between subsidiaries are more prone to it than others, such as those related to:

- Intangible assets, especially those which lack comparables and are thus hard to value;
- Allocation of risks (financial, market, operational risks) ;

- Management fees and head office expenses, particularly the way in which they are distributed within the MNE group.

Keep an eye out for other BEPS practices

133. Among the other BEPS practices that would be of particular concern for trade unions:

- Biased allocation of debt within the MNE group that would overburden some subsidiaries with excessive interest payments;
- Weakening of the balance sheet of a subsidiary by shifting intellectual property rights to preferential regimes offering “patent boxes”;
- Opaque group structures for the purpose of treaty shopping; and
- Legal artifice to escape the “permanent establishment” status.

About this report

This paper was drafted by Michael Tyrala (PhD candidate, City University of Hong Kong michaeltyrala@gmail.com) under the supervision of Pierre Habbard, TUAC Secretariat/

References

[i] OECD. (2013) *Action Plan on Base Erosion and Profit Shifting*. OECD Publishing. https://www.oecd.org/ctp/BEPSActionPlan.pdf / OECD. (2015) *BEPS 2015 Final Reports*. OECD Publishing. http://www.oecd.org/ctp/beps-2015-final-reports.htm

[ii] BMG. (2013) *What is the BEPS Monitoring Group*. The BEPS Monitoring Group. https://bepsmonitoringgroup.wordpress.com/what-is-the-beps-monitoring-group/ / BMG. (2015) *Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project*. The BEPS Monitoring Group. https://bepsmonitoringgroup.files.wordpress.com/2015/10/general-evaluation.pdf /Avi-Yonah, Reuven S. & Xu, Haiyan. (2016) Global Taxation after the Crisis: Why BEPS and MAATM are Inadequate Responses, and What Can Be Done About It. *Public Law Research Paper Series* No. 494: p. 1-50. http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2716124

[iii] Picciotto, Sol. (2012) *Towards Unitary Taxation of Transnational Corporations*. Tax Justice Network. http://www.taxjustice.net/cms/upload/pdf/Towards_Unitary_Taxation_1-1.pdf

[iv] OECD. (2013) *Tax Administration 2013 - Comparative Information on OECD and Other Advanced and Emerging Economies*. OECD Publishing: p. 86. http://www.oecd.org/ctp/administration/tax-administration-series.htm

[v] Joint Civil Society. (2016) *Why Public Country-by-Country Reporting for Large Multinationals is a Must: Questions and Answers*. http://financialtransparency.org/wp-content/uploads/2016/02/Joint_Civil_Society_QA_pCBCR.pdf

[vi] PwC. (2014) *General assessment of potential economic consequences of country-by-country reporting under CRD IV*. Study prepared by PricewaterhouseCoopers for European Commission DG Markt following the contract 2014/S 102-177729. http://ec.europa.eu/internal_market/company/docs/modern/141030-cbcr-report_en.pdf

[vii] ICIJ. (2014) *Luxembourg Leaks: Global Companies' Secrets Exposed*. International Consortium of Investigative Journalists. http://www.icij.org/project/luxembourg-leaks

[viii] ActionAid. (2012) *Calling Time: Why SABMiller Should Stop dodging Taxes in Africa*. https://www.actionaid.org.uk/sites/default/files/doc_lib/calling_time_on_tax_avoidance.pdf

[ix] PRI. (2015) *Engagement Guidance on Corporate Tax Responsibility: Why and How to Engage With Your Investee Companies*. Principles for Responsible Investment. http://2xjmlj8428u1a2k5o34l1m71.wpengine.netdna-cdn.com/wp-content/uploads/PRI_Tax-Guidance-20151.pdf

[x] EPSU, EFFAT, SEIU & War on Want. (2015) *Unhappy Meal: €1 Billion in Tax Avoidance on the Menu at McDonald's*. European Federation of Public Sector Unions, European Federation of Food, Agriculture and Tourism Trade Unions, Service Employees International Union and War on Want. http://www.epsu.org/IMG/pdf/Unhappy_meal_joint_fin_report_EN.pdf / ITF. (2015) *Chevron's Tax Schemes: Piping profits out of Australia?* International Transport Workers' Federation. http://www.itfglobal.org/media/1152801/itf-chevron-report.pdf

[xi] G20. (2015) *G20 Leaders' Communiqué*. Antalya Summit. http://g20.org.tr/g20-leaders-commenced-the-antalya-summit/

[xii] http://www.oecd.org/tax/first-meeting-of-the-new-inclusive-framework-to-tackle-base-erosion-and-profit-shifting-marks-a-new-era-in-international-tax-co-operation.htm

---

[xiii] Picciotto, Sol. (1992) *International Business Taxation: A Study in the Internationalization of Business Regulation*. Cambridge: Cambridge University Press.

[xiv] Palan, Ronen; Murphy, Richard & Chavagneux, Christian. (2010) *Tax Havens: How Globalization Really Works*. Ithaca: Cornell University Press.

[xv] OECD. (1998) *Harmful Tax Competition: An Emerging Global Issue*. OECD Publishing. http://www.oecd.org/tax/transparency/44430243.pdf

[xvi] The Economist. (2000) *A survey of globalization and tax: Gimme shelter*. Special report, January 27. http://www.economist.com/node/276995

[xvii] Sharman, Jason C. (2006) *Havens in a Storm: The Struggle for Global Tax Regulation*. Ithaca: Cornell University Press.

[xviii] Mitchell, Austin & Sikka, Prem. (2011) *The Pin-Stripe Mafia: How Accountancy Firms Destroy Societies*. Association for Accountancy & Business Affairs. http://visar.csustan.edu/aaba/PINSTRIPEMAFIA.pdf

[xix] ITUC & TUAC. (2013) *A review of the G20 agenda on tax avoidance and on long-term investment*. Economic Briefing by the International Trade Union Confederation and the Trade Union Advisory Committee to the OECD. http://www.tuac.org/en/public/e-docs/00/00/0D/83/document_doc.phtml

[xx] IBAHRI. (2013) *Tax Abuses, Poverty and Human* Rights. A report of the International Bar Association's Human Rights Institute Task Force on Illicit Financial Flows, Poverty and Human Rights. http://www.ibanet.org/Article/Detail.aspx?ArticleUid=4A0CF930-A0D1-4784-8D09-F588DCDDFEA4

[xxi] ITUC & TUAC. (2013) Joint expert meeting on Corporate Tax Planning, 29 November 2013. http://www.tuac.org/en/public/e-docs/00/00/0D/FE/document_doc.phtml

[xxii] OECD. (2013) *Action Plan on Base Erosion and Profit Shifting*. OECD Publishing. https://www.oecd.org/ctp/BEPSActionPlan.pdf

[xxiii] OECD. (2014) *Release of a discussion draft on Action 4 (Interest deductions and other financial payments)*. http://www.oecd.org/tax/aggressive/discussion-draft-action-4-interest-deductions.htm

[xxiv] IDA Ireland. (2015) *Knowledge Development Box*. http://www.idaireland.com/how-we-help/resources/infographics/knowledge-development-box/

[xxv] Farrell, Henry. (2016) *Apple may owe Ireland $19 billion, but Ireland doesn't want the money. Here's why*. The Washington Post. https://www.washingtonpost.com/news/monkey-cage/wp/2016/01/29/apple-may-owe-ireland-19-billion-but-ireland-doesnt-want-the-money-heres-why/

[xxvi] BMG. (2015) *Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project*. The BEPS Monitoring Group. https://bepsmonitoringgroup.files.wordpress.com/2015/10/general-evaluation.pdf

[xxvii] Ibid.

[xxviii] OECD. (2013) *Action Plan on Base Erosion and Profit Shifting*. OECD Publishing. https://www.oecd.org/ctp/BEPSActionPlan.pdf

[xxix] OECD. (2015) *BEPS 2015 Final Reports*. OECD Publishing. http://www.oecd.org/ctp/beps-2015-final-reports.htm / OECD. (2009) *Economic Policy Reforms: Going for Growth 2009*. OECD Publishing. http://www.oecd.org/eco/growth/economicpolicyreformsgoingforgrowth2009.htm / OECD. (2012) Income inequality and growth: The role of taxes and transfers. OECD *Economics Department Policy Notes*, No. 9. January 2012. https://www.oecd.org/tax/public-finance/49417295.pdf

[xxx] OECD. (2015) *BEPS 2015 Final Reports*. OECD Publishing. http://www.oecd.org/ctp/beps-2015-final-reports.htm

[xxxi] OECD. (2016) *Mutual Agreement Procedure Statistics 2006-2013*. http://www.oecd.org/ctp/dispute/map-statistics-2006-2013.htm

[xxxii] BMG. (2015) *Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project*. The BEPS Monitoring Group. https://bepsmonitoringgroup.files.wordpress.com/2015/10/general-evaluation.pdf