C20 TURKEY
POLICY PAPERS

GOVERNANCE
(TAX JUSTICE)

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73%
of the world's largest companies - multinationals operating in several countries - disclose no information about the amount of tax they pay in foreign countries (Transparency International).

The long-run revenue losses from BEPS to developed countries are estimated at **0.6%** of GDP, and for developing countries at **2%** of GDP (IMF).

The developing world lost **US$6.6 trillion** in illicit financial flows (capital outflows that stem from crime, corruption, tax evasion and other illicit activity) from **2003-2012** (Global Financial Integrity).

C20 TURKEY TAX JUSTICE POLICY PAPER

SUMMARY OF POLICY RECOMMENDATIONS

Taxation is key to financing sustainable development, and reform of international corporate taxation is essential to restoring its legitimacy, as well as to ending the use of the tax haven and offshore secrecy system for facilitating capital flight and concealing the proceeds of crime and corruption. Our recommendations are:

On corporate and financial transparency, the G20 should

- consider how to extend the Beneficial Ownership registry system to all jurisdictions worldwide;
- ensure that all Beneficial Ownership registries are public;
- make a clear commitment to a multilateral mechanism for automatic exchange of information with all willing countries, and with a transitional mechanism to allow developing countries to benefit from receiving information while adapting to the requirements to send information;
- require all participants to collect and publish annually statistical data on the aggregate sums passing through their financial system, broken down by country of residence of the account holder and of controlling persons.

EXTEND THE BENEFICIAL OWNERSHIP REGISTRY SYSTEM TO ALL JURISDICTIONS WORLDWIDE

On reform of international corporate taxation:

- Country-by-Country reports should be filed directly with all tax authorities where the MNE has a taxable presence, and in our view these reports should be published;
- interest deductions should be limited so that they are no greater in aggregate than the consolidated interest costs of the corporate group as a whole;
- G20 Leaders should adopt a High Level Declaration which would commit states to end all harmful tax practices and ensure transparency especially of tax incentives and tax rulings;
- procedures for settling international tax disputes should comply with due process standards, including truly independent adjudicators and reasoned decisions which are published, and countries should not be pressured into accepting adjudication if they consider it unsuitable for them;
- all G20 countries should commit to rapid insertion of development friendly provisions in their treaties with developing countries, and of strong purposive and anti-abuse provisions in all their tax treaties, preferably by inclusion of such provisions as core and compulsory elements in the proposed multilateral convention;

- the BEPS Project outputs should be regarded not as an end but as the beginning of a longer and more inclusive process to achieve reforms which could benefit all countries and truly ensure that multinationals are taxed where their economic activities take place.

BACKGROUND

Taxation is central to good governance and promoting development and equality

Increasing public revenue through progressive taxation is crucial to finance essential public goods, services and investments, for fighting inequality, realising human rights, and for ensuring implementation of the sustainable development goals (SDGs). Furthermore, ending the use of tax havens and the offshore secrecy system for both tax evasion by wealthy persons and tax avoidance by multinational enterprises (MNEs) is crucial in curbing capital flight and the laundering of the proceeds of corruption and crime.

ENSURE THAT ALL BENEFICIAL OWNERSHIP REGISTRIES ARE PUBLIC

The G20 has delegated the work on these issues to the Organisation for Economic Cooperation and Development (OECD), the rich countries' club, on the grounds that it has the technical capacity. Although the OECD has extended participation in this work to all G20 countries, and more recently some other developing countries and regional tax administration networks, it cannot substitute for a truly inclusive global body. We were disappointed that a number of OECD countries blocked proposals from developing countries at the 3rd International Conference on "Financing for Development" to create such a body. Given this unsuitable institutional framework, it is hardly surprising that the measures produced by the OECD/G20 working groups will be at best partially effective, and will pose major problems of implementation, especially for developing countries.

Corporate and Financial Transparency

Some progress has been made towards fulfilling the G20's pledge to establish registries for beneficial ownership (BO) of legal entities; the EU's recent Anti-Money-Laundering Directive is a significant step towards this, though questions remain, particularly about (a) trusts, and (b) access to the data by interested persons. Similarly, progress has been made in establishing the Common Reporting Standard for Automatic Exchange of Information (AEoI); but unless there is a viable process for developing countries to easily participate in AEoI, the G20 promise that the 'era of bank secrecy is over' will be broken. In particular, allowing countries to choose with which others they will exchange information will create a severe disadvantage for weaker countries. The Global Forum Roadmap report to the Development Working Group identified the main problem as the need to reduce costs and increase benefits of AEoI to developing countries. What is now needed is more ambition in the solutions.

Base Erosion and Profit Shifting (BEPS)

The G20 world leaders in 2013 mandated the BEPS project to produce reforms of international tax rules which would ensure that multinational enterprises (MNEs) could be taxed 'where economic activities take place and where value is created', and that developing countries should also be able to benefit.

The BEPS project has the potential to put an end to tax avoidance by multinational enterprises through tax havens, and so help to raise corporate tax revenues in developing countries and developed countries alike. Reform is long overdue to the existing rules, which are now over 80 years old. Their fundamental flaw is that they have been interpreted to require taxation of MNEs as if their various constituent entities are independent of each other and dealing 'at arm's length'. This creates a perverse incentive to create complex and fragmented corporate structures, locating affiliates in convenient jurisdictions to minimise tax, and MNEs now consist of often hundreds of such entities.

The G20 mandate implied a new approach, to treat the corporate group of an MNE as a single firm, and attribute its tax base according to its real activities in each country. Unfortunately, the OECD has refused to make this explicit, but has continued to emphasise the arm's length principle, while attempting to counteract its harmful consequences. As a result, the BEPS outputs fail to provide a coherent and comprehensive approach, and offer instead a patch-up approach. Regrettably, several of the proposals have been greatly weakened by the insistence of some powerful OECD states on preserving their preferred tax breaks for business, notably weak CFC rules and innovation box schemes, while others have stubbornly defended the dysfunctional arm's length principle.

Those proposals which could be effective do indeed move towards treating MNEs in accordance with their business reality as unitary firms. The major advance is the proposals for Country by Country Reporting, which would for the first time enable tax authorities to evaluate the MNE as a whole.

MAKE A CLEAR COMMITMENT TO A MULTILATERAL MECHANISMS FOR AUTOMATIC EXCHANGE OF INFORMATION WITH ALL WILLING COUNTRIES

However, the threshold of €750m is too high, and the arrangements for filing and access are weak. All countries need access to these reports, yet that may be impeded under the proposed cumbersome scheme. There is no convincing argument to suggest these reports would contain commercially confidential information and hence they should be published. This would facilitate research and analysis of whether the international tax rules are meeting their stated objectives, and reassure the public.

The proposals on limiting interest deductions also began by treating MNEs as unitary, but have been weakened; a firm rule is needed that interest deductions should not be greater in aggregate than the corporate group's consolidated interest costs to third parties.

Strong rules on Controlled Foreign Corporations could also do much to discourage MNEs from shifting income out of operating affiliates in source countries and parking them untaxed in countries with lower effective tax rates; but the proposals are extremely weak and will encourage a continued race to the bottom in tax.

An essentially self-policing system is proposed for regulating harmful tax practices, continuing the approach begun in 1998, which has had very limited effects. Already it can be seen that the attempt to apply the broad principles of 'nexus' and 'substance' to innovation boxes is only leading to a complicated system restricting some schemes while legitimising the concept, thus encouraging all countries to adopt their own regime and eroding the corporate tax rate as a whole. Economically harmful tax incentives have proliferated in recent years, with many countries, especially developing countries sacrificing large percentages of GDP for no or limited return. As recommended by the OECD/World Bank/IMF and UN to the G20 in 2011, G20 members should take the lead in providing showing best practice in transparency, monitoring, review, and accountability of tax incentives. A more binding framework is needed, with provisions for counter-measures. Furthermore, the general problem of tax competition needs to be addressed, as also called for in the OECD reports on low income countries, to stem the race to cut corporate tax rates, which places tax burdens disproportionately on poor people and households.

The proposals on transfer pricing are particularly disappointing, as they still begin from the arm's length principle, allowing tax authorities to challenge intra-firm arrangements only by recharacterising transactions based on a 'facts and circumstances' analysis of functions, assets and risks, and searching for 'comparables' which both theory and practice show do not exist. This will require considerable skilled resources, challenging even for OECD tax authorities, let alone developing countries, increase compliance costs especially for SMEs, and leave wide scope for subjective and discretionary decisions. Work was begun on the profit split method, which could offer a way forward towards a unitary approach, but has been deferred for the next stage.

MAKE SURE COUNTRY BY COUNTRY REPORTS ARE FILED DIRECTLY WITH ALL TAX AUTHORITIES WHERE MNES HAVE A TAXABLE PRESENCE

The reply to business fears of greater conflicts is to propose stronger dispute settlement, including a commitment by many OECD countries to mandatory binding arbitration. It is a totally inappropriate response to deal with problems caused by vague rules by entrusting decisions involving often hundreds of millions of dollars to a secret and unaccountable procedure of third party adjudication. The primary aim of tax treaties should now be seen as ensuring that tax is actually paid according to the level and location of real economic activity. The most effective way to ensure this would be inclusion of strong purposive and anti-abuse provisions in the proposed multilateral convention , and to develop new principles for 'development friendly' tax treaties with developing countries.

It is clear that much more work is needed to follow up and go beyond the BEPS project. This should include a reconsideration of the allocation of tax rights between the countries of residence and source, an issue addressed in the BEPS project only in its action on the Digital Economy. In reality, this is part of a much wider challenge resulting from dematerialisation of production, including the shift to services, and is of special concern to developing countries. Other priority issues for developing countries have also been identified by the G20 Development Working Group, but they are being addressed only by developing toolkits, generally adhering to approaches approved by the OECD.

INVEST IN MORE IMAGINATIVE ALTERNATIVE APPROACHES, SUCH AS SOUTH-SOUTH COOPERATION, BUILDING ON REGIONAL GROUPS SUCH AS ATAF AND CIAT

What is needed instead is more imaginative alternative approaches, complementing and going beyond the work of the OECD. These should include South-South cooperation, building on regional groups such as ATAF and CIAT, and strengthening the role of the UN Committee.

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- Oxfam
- Christian Aid
- International Tax Research Foundation
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- Tax Justice Network