Nurse Lucy Chilinda at a hospital in Lilongwe, Malawi (2007). Fair tax regimes are vital to enable governments to uphold citizens' rights to basic services such as healthcare and education. Photo: Abbie Trayler-Smith/Oxfam

BUSINESS AMONG FRIENDS

Why corporate tax dodgers are not yet losing sleep over global tax reform

Tax dodging by big corporations deprives governments of billions of dollars. This drives rapidly increasing inequality. Recent G20 and OECD moves to clamp down on corporate tax dodging are a first step, but these have woken up a legion of opponents set on undermining them. Most developing countries, which lose billions to corporate tax dodging annually, are also being left out of the decision making. Commercial interests must not be allowed to pursue their agenda at the cost of the public interest. All developing countries must be included in negotiations, and corporations must pay what they owe.

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INTRODUCTION

In 2009, in response to the financial recklessness and murky tax rules that plunged the world into financial crisis, G20 leaders declared an end to banking secrecy and vowed to clean up the international tax system. It is only now, five years on, that meaningful action against secrecy and corporate tax abuse is beginning.

A number of high-profile companies, including Apple,[1] Starbucks,[2] and others, have been exposed for dodging their taxes and cheating the system. They have indulged in artificial tax schemes and 'profit shifting': registering losses in countries with high tax rates, and profits in tax havens with low tax rates.

In response to public anger and gaps in national budgets, G20 governments commissioned the Organisation for Economic Co-operation and Development (OECD) to propose action to curb profit shifting and other tricks exploited by multinational companies (MNCs) that erode governments' tax bases. The current system of dysfunctional international rules and treaties allows many MNCs to pay minimal tax bills relative to their real profits, and avoid paying their fair share. But, if designed appropriately, the OECD's 'Action Plan on Base Erosion and Profit Shifting' (BEPS), released in 2013, could provide a much-needed opportunity to modernize the international tax system and make it fit for purpose. However, unless urgent action is taken, the initiative looks likely to replicate the same defects that have afflicted the current international tax system.

This paper shows how big businesses, by escaping their tax liabilities, constrain the ability of governments to tackle inequality – particularly that of developing countries. Importantly, it also shows how tax rules are rigged in favour of MNCs, and how the G20's current approach to tax reform is at risk of being dominated by a legion of corporate lobbyists, and is therefore likely to create a new international system that does little to benefit ordinary people.

FISCAL JUSTICE: THE FAIR APPROACH TO REDUCING INEQUALITY

In many countries, economic inequality has reached extreme levels and continues to grow. If left unchecked, it will weaken global efforts to eradicate poverty. Fair tax regimes are vital to finance well-functioning states and enable governments to fulfil their obligations to uphold citizens' rights to basic services, such as healthcare and education.

The International Monetary Fund (IMF) has recently made a strong case for the effectiveness of redistributive fiscal policies in decreasing or offsetting the effect of growing inequality, particularly in economies where tax accounts for a higher ratio to gross domestic product (GDP).[3]

Oxfam supports the use of progressive taxation and spending to reduce inequality. Taxing companies, particularly successful multinationals, is one of the most progressive forms of taxation. All companies must pay their fair share of taxes, according to their means. They should not be allowed to escape their obligations to the societies in which they operate and where they generate their profits.

1 MULTINATIONAL COMPANIES ESCAPING TAX LIABILITIES: A GROWING PROBLEM WITH GLOBAL IMPACTS

It is impossible to calculate the true extent of the financial losses that all countries sustain because multinationals do not pay taxes proportionate to their real profits. Nevertheless, conservative estimates for potential tax losses are in the billions.

What is clear is that in all OECD countries the rates of return to private capital have soared since the 1980s. This has resulted in a worldwide trend of rising corporate profits as a share of the economy. However, while corporate profits have risen, their increase has not been matched by a rising trend in income tax contributions. In fact, on average, the opposite is happening.[4] The OECD has also found that MNCs pay as little as 5 percent in corporate tax, while small companies pay as much as 30 percent.[5]

This situation can mostly be explained by two phenomena: multinational business shifting profits or otherwise structuring cross-border transactions to avoid their tax liabilities; and companies securing tax incentives from governments bidding to attract foreign investment. The tax gap for developing countries – the amount of unpaid tax liability faced by companies – is estimated at $104bn every year (including profits shifted in and out of tax havens).[6] Governments in these countries then give away an estimated $138bn each year in statutory corporate income tax exemptions.[7] These losses combined could pay twice over the $120bn[8] needed to meet the Millennium Development Goals (MDGs) related to poverty, education and health.

Governments are being starved of vital resources on a momentous scale. As tax returns from capital fall, they are left with two options: to cut back on the essential spending needed to reduce inequality and deprivation; or to make up the shortfall by levying higher taxes on other less wealthy sections of society. Consequently, wealth is redistributed upwards, and the inequality gap grows.[9]

AGGRESSIVE TAX PLANNING AND PROFIT SHIFTING: HOW IT HAPPENS

Over recent years, several factors have combined to undermine the integrity of corporate income tax worldwide. First, the process of globalization (and with it, financial, investment and trade liberalization) has changed the way companies operate. For MNCs, national borders no longer exist, yet tax systems remain under national government administrations or jurisdictions. Each jurisdiction is characterized by different legislative structures and policy objectives that often contradict or compete with each other.

Some countries attempt to attract MNCs and rich individuals who want to pay as little tax as possible by cutting tax rates; by offering tax loopholes and special incentives; by offering financial secrecy to facilitate tax evasion; and they impede scrutiny of tax avoidance or are deliberately lax about tax enforcement. This gives rise to tax 'competition', which companies can abuse to minimize their tax liabilities.

MNCs that adopt aggressive tax-planning strategies rely on the mismatches and gaps that exist between the tax rules of different jurisdictions. They minimize corporate tax contributions by making taxable profits 'disappear' by shifting profits to low-tax operations where there may be little or no genuine economic or profit-making activity. They can artificially attribute the ownership of assets or the locations of transactions to paper subsidiaries in secret jurisdictions with zero or low nominal tax rates, known as 'tax havens'.[10]

Tax havens operate through 'empty' structures that often have no connection to the location or substance of the company's economic activity. By doing this, they minimize taxation of business profits at the source (where the real income is generated) and destination (where the MNC's head office is 'tax-resident').[11] Another typical tax-abuse strategy is transfer mispricing: the practice of deliberate over-pricing of imports or under-pricing of exports of goods and services between the subsidiaries of the same companies. While deliberate transfer mispricing in theory constitutes unlawful tax *evasion*, in practice current tax rules allow companies to set the prices of many company-specific goods and services more or less arbitrarily, making them nearly impossible for developing country tax authorities to challenge.

A number of successful world-renowned branded companies have found themselves in the spotlight recently accused of tax dodging. They include Apple, Amazon,[12] Google,[13] Vodafone,[14] Ikea,[15] eBay,[16] Zara,[17] and Starbucks, among others. In his speech to global leaders at the World Economic Forum in Davos, UK Prime Minister David Cameron said, in an apparent swipe at Starbucks, 'c*ompanies need to wake up and smell the coffee, because the customers who buy from them have had enough of businesses that think they can carry on dodging their fair share of taxes or that they can keep on selling to the UK and setting up ever more complex tax arrangements abroad to squeeze their tax bill right down.'*[18]

French President François Hollande said, ahead of his recent visit to the US to meet President Obama, *'When I go to the US in a few days, we have agreed with President [Barack] Obama to make this effort on tax harmonization.'* The French government has recently clashed with internet giant Google over its tax planning in France. The French government is seeking €1bn in tax from Google. '*This is not acceptable and that is why, at both the European and the global level, we must ensure that tax optimization... can be called into question.'*[19]

Political leaders have started to publicly declare their intention to tackle corporate tax dodging, but it remains to be seen whether their words will be followed with action.

DEVELOPING COUNTRIES HARMED MOST BY CORPORATE TAX ABUSE

In 2013, Kofi Annan said, for richer nations '*if a company avoids tax or transfers the money to offshore accounts what they lose is revenues; here on our continent, it affects the life of women and children – in effect in some situations it is like taking food off the table for the poor*.'[20]

Revenue loss from businesses dodging their tax payments harms poorer economies most, as corporate tax revenues comprise a higher proportion of their national income. Examples of corporate tax dodging and its impact can be found on every continent.

'Africa loses twice as much money through these loopholes as it gets from donors.'

Kofi Annan, May 2013

The problem for African countries is enormous. According to the Africa Progress Panel, an average of $38.4bn was lost to African countries annually through trade mispricing between 2008 and 2010, representing billions of dollars in lost tax revenues.[21] In Bangladesh, each year the government loses around $310m in tax revenues. An audit by Peru's tax administration of only 27 cases of transfer pricing in 2013 revealed undeclared earnings of $350m, representing evaded taxes estimated at $105m.

Corporate income tax is enormously important to developing countries. It comprises a significant share of total tax receipts – around 18 percent – in low-income and lower middle-income countries.[22] More frequently promoted sources of tax revenue, such as value-added-tax (VAT), are often more regressive and therefore would increase inequality. Increasing revenues from personal income tax collection, even using a progressive approach to taxation, is still challenging because tax administrations are often too under-resourced to collect from a more diverse tax base. To illustrate this point, it has been calculated that more than 650,000 additional tax officials would need to be employed in sub-Saharan African countries for the region to have the same ratio of tax officials to population as the OECD average.[23]

Box 1: Missing corporate tax revenues in Bangladesh

The NBR (National Board of Revenue) of Bangladesh estimates that multinational companies siphon off about $1.8bn from the country each year due to the weak transfer pricing monitoring mechanism. As a result, the government has been deprived of around $310m every year in tax revenues.[24] This could pay for around one-fifth (20.4 percent)[25] of the primary education budget in Bangladesh – vital resources in a country where there is only one teacher for every 75 primary school-aged children.[26]

According to a leaked Ministry of Finance report, British American Tobacco Bangladesh dodged a tax bill of around $250m by making false price declarations on their two cigarette brands – Bristle and Pilot – between 2009 and 2013. It is alleged the company declared their medium-level raw materials, including tobacco, paper and others, as low-level brand in order to evade tax. BATB hid the production cost and escaped a vast sum in taxes.[27]

Box 2: Peru takes action to counter loss of tax revenues

SUNAT (Peru's tax administration) is committed to counter the bleeding away of revenue through transfer pricing.[28] It estimates that between 2007 and 2012, 590 companies conducted commercial transactions involving transfer pricing operations, which amounted to $370bn; up to 65 percent of these transactions were international in nature.

Transfer pricing has become a critical issue for SUNAT because it is estimated that commercial transactions involving transfer pricing mechanisms in Peru have an aggregated annual value equivalent to 26 percent of GDP. Consequently, SUNAT is actively prompting public debate on assessing the impact of transfer pricing in less developed economies and the need for capacity building.

During 2013, the tax administration managed to audit only a fraction (27 cases) of all transactions involving transfer pricing, and detected evaded taxes equivalent to $105m; almost enough to fund the whole maternal neonatal public programme. Assuming that authorities could duly monitor and audit all transfer pricing operations and that the evasion ratio was the same as in the 2013 sample, the Peruvian government could collect an estimated $3.36bn in additional tax revenues, equivalent to 84 percent of the country's education budget.[29]

These examples make a clear case that tackling corporate tax dodging is essential to give developing countries a fair chance of meeting people's rights to public services, and tackling poverty and inequality. That is why the G20 and OECD processes would be irresponsible to ignore the need to clamp down on the corporate tax dodging that sucks billions out of developing countries every year, and their right to participate on an equal footing in the decision making process.

COMPETITION TO OFFER LOW TAX ENVIRONMENTS FOR MULTINATIONAL COMPANIES

Low taxation growth models are the cornerstone of many governments' growth strategies. Some governments strive to offer the most preferable tax regimes through tax incentives, exemptions, opaque financial facilities and low or no tax rates (as discussed above), the theory being that a low tax economy attracts businesses to invest or operate in the country. This pits many economies against each other as to who can offer the most favourable tax environment to attract foreign direct investment (FDI).

This kind of 'race to the bottom' often brings greater benefits to multinationals and their shareholders, than to the citizens and governments of developing countries. Governments have sovereign power to set national policy related to attracting FDI, which is largely determined by their political and economic priorities. International tax rule reforms, such as the G20/OECD BEPS project, do not, regrettably, directly tackle the issue of tax incentives.

Despite this, many developing countries, desperate to attract FDI, often accept the unfair conditions imposed by powerful MNCs when negotiating contracts, for fear the companies will take their business elsewhere. Some developing countries offer special incentives and even tax holidays – incentives that are not available to domestic firms and so make it even harder for them to compete on an equal footing. Discretional tax incentives are a factor contributing to inequality. They create a double standard between international and domestic companies without adding any social value, and reap less revenue to invest in essential public services like health and education, which are critical to reducing economic inequality.[30]

Take the case of Sierra Leone, where economic inequality is high. In 2011, the government lost more on tax incentives than it spent on its development priorities. In 2012, tax expenditure amounted to an astonishing 59 percent of the entire government budget. Put another way, government tax expenditure in 2012 amounted to more than eight times the health budget and seven times the education budget.[31]

If Ethiopia could capture just 10 percent of the money it loses each year through tax exemptions, it could enrol 1.4 million more children in school.[32] Some governments try to resist such pressure, as the example of Niger and the mining giant Areva illustrates (see Box 3).

Box 3: Poor countries' ability to negotiate fair tax deals: the experience of the Nigerien government and mining company Areva

Niger is in the unenviable position of being ranked lowest on the United Nations Human Development Index, with 60 percent of its population living on less than $1 a day. Yet Niger is also the world's fourth-largest uranium producer. The country has received very little in return for the exploitation of its valuable natural resource. Uranium still represents over 70 percent of Niger's exports, but only accounts for around 5 percent of the country's budget.

Areva, a French company which is 86 percent state-controlled[33] and a leader in global nuclear energy, has been mining uranium in Niger for more than 40 years. During this time it has negotiated a number of tax privileges such as exemptions from duties, VAT, fuel taxes, and a deal to exclude a portion of their profits from taxation.

At the end of 2013, Areva's latest 10-year deal with the Nigerien government expired, so the two parties have been negotiating a new contract. The government wants to apply a new law that would remove exemptions on duties and VAT, and change the royalty rate (to rise progressively from 5.5 percent to 12 percent, depending on the company's performance). By comparison, a royalty rate in, for example, Canada could typically be around 12 percent.

Areva heavily resisted these changes and, at the time of writing this report, negotiations had stalled. The company claimed that paying these taxes would make its business unprofitable. Yet Areva is actively exploring new deposits and intends to continue mining.[34] However, as Areva do not disclose the profits generated from mining in Niger, its claims are difficult to contest.

Meanwhile, Niger's national budget is around $2.7bn. Niger desperately needs additional revenue to sustain and improve basic services like education and free access to healthcare (which is under threat), and to invest in agriculture to address the threat to lives and livelihoods caused by recurring food crises. Official aid currently accounts for 40 percent of Niger's budget. Just by removing Areva's exemption on VAT, the country could earn as much as $20m a year. In 2013, $20m represented 5.6 percent of Niger's education budget,[35] which could pay for more than 200,000 primary school children to go to school.[36]

A number of studies[37] [38] show that offering tax breaks to attract inward investment is a policy tool that has been over-promoted, without real evidence of any strong pay-offs in development terms. Besides access to natural resources, the key determinants of a country's ability to attract FDI are political and macroeconomic stability, an educated workforce, good transport, electricity and telecommunications infrastructure, and large markets, or labour costs[39] – most of which are financed through the payment of taxes. Empirical studies do not show the tax environment to be a key driver for foreign investment. Such tax incentives are, in effect, a government trade-off, designed to subsidize big (international) business to the detriment of citizens' social welfare and the provision of public goods. There is an urgent need for measures to reverse competition for FDI, which only serves to drive tax revenues downwards.

THE NEED FOR RULES THAT WORK FOR THE INTERESTS OF ALL

The interminable pursuit of short-term profit maximization through corporate tax dodging is now an integral component of companies' growth and profit strategies. Although such practices are highly questionable from an ethical standpoint, they are often not illegal. But quibbling over their legality misses the point. It is time to develop rules that are fair and work in the interests of all – particularly developing countries and citizens – rather than being captured to serve the interests of powerful corporates and advanced economies. Moreover, corporates that dodge their tax liabilities by utilizing tax haven jurisdictions in countries where they are not actually operating (or have tax obligations) are, in effect, 'free riders'. They benefit from public spending in their home country, or wherever they create taxable wealth and profits, yet avoid contributing to its financing.[40]

2 THE G20 BASE EROSION AND PROFIT SHIFTING ACTION PLAN: A FLAWED EXERCISE

The 'Action Plan on Base Erosion and Profit Shifting' (BEPS)[41] proposed by the OECD and approved by the G20 seeks to redefine international tax rules to curb the profit shifting activity described above, and ensure companies pay taxes where the economic activity takes place and value is created.[42] The action plan should be ready for implementation by the end of 2015. However, there are several reasons why this process, in its current state, will not deliver an outcome that leads to more progressive tax systems worldwide where multinational companies pay their fair share of tax or do so where the value is generated.

Firstly, the business lobby currently has a disproportionate influence on the process, which it uses to protect its interests. Correcting the rules that allow the tax dodging practices of global giants like Google, Starbucks and others that lead to tax revenue losses in OECD countries will be difficult, given the size of the corporate lobby. But worse, perhaps, is that the interests of non-OECD/G20 countries are not represented at all in these negotiations. As Kofi Annan said in 2013, *'... tax evasion, avoidance, secret bank accounts, are problems for the world… so we all need to work together, … to work to ensure we have a multilateral solution to this crisis.'*[43]

DISPROPORTIONATE INFLUENCE OF THE BUSINESS LOBBY

Oxfam acknowledges the efforts of the OECD to make these negotiations more transparent by organizing public online consultations and public meetings. This may not be enough, however, to counter the considerable private lobby set to resist change. A major concern is the unjustifiable and disproportionate influence that business interests have on the OECD and member governments' policy making, particularly compared with the lack of influence wielded by countries outside the G20/OECD BEPS process. Economic inequality is synonymous with political inequality. Too often, the interests of powerful governments and influential companies are over-represented in public policy making. Not only is this a threat to representative democracy, it also serves to entrench and increase inequality.

For example, at the end of 2013, the OECD opened consultations to 'stakeholders'[44] to comment on new draft rules on tax treaty abuse, hybrid mismatch arrangements, digital economy, and transfer pricing and country-by-country reporting (CBCR). Looking at CBCR; establishing a template for CBCR represents a positive initiative by the OECD towards greater transparency as it will oblige foreign companies to release information on where they work, have real economic activity, and how much tax they pay. However, CBCR will only be effective if the information is comprehensive, presented in an easily accessible form, and is publicly disclosed.[45]

However, on just the CBCR consultation, almost 87 percent of the contributions have come from the business sector, none from developing countries' tax authorities, and the remaining 13 percent include contributions from NGOs (eight, including Oxfam), academics (seven), experts related to tax administrations (two) and one trade union. More striking, of 135 contributions in total, only five come from developing countries; 130 come from rich countries with a large proportion (43 percent) coming from the UK and the US.

Unsurprisingly, the business sector is almost all opposed to the proposal. Only six percent of the private sector supported CBCR, and only two contributions were in favour of making this information public to improve accountability. Some of the companies that have objected to making this information public are the same companies that have been involved in recent tax scandals (though SABMiller,[46] for example, unlike a number of multinationals, does now disclose the tax it pays on its website [47]). This shows a clear picture of who the OECD receives inputs from and it is no surprise that there is resistance to change from those who would benefit[48] from the status quo.

The OECD recently announced following the 2013 consultation that critical reporting requirements will be dropped, including reporting on transactions relating to royalties, interests and service fees (at the centre of a number of profit shifting scandals), and that data will not be made public. The global accountancy firm, KPMG (Switzerland) reported this as 'good news'.[49]

Private companies are, of course, entitled to put forward their views in this open and transparent process, but because representation is unbalanced, it is likely to lead to a biased outcome. Other stakeholders, especially from developing countries, have neither the capacity nor the level of information or access to decision makers that MNCs have. For example, one informal group of US digital firms, whose membership is not entirely known, has contributed to the OECD consultation on tax challenges of the digital economy (within BEPS) through the US law firm Baker & McKenzie.[50] One of the signatories to the contribution was, until 2011, an OECD employee, where she had been playing a senior role in tax policies affecting global online and hi-tech groups.

The OECD recently announced that the new head of its Transfer Pricing Unit was until recently a partner at KPMG (London).[51] It is reasonable and fair to recruit the best-qualified staff for a role, and their personal integrity should not be questioned. As a general principle, though, staff – in any area of public policy making – should not go back and forth from policy-making institution to private lobby firm if that firm has an interest in influencing a policy process in which there might be a conflict of interest.[52] This revolving door between tax legislators and accountancy firms' advisers should be closed, the latter of whom often influence the design of government tax policies that contain the loopholes that they then sell to clients. The UK parliament's Public Accounts Committee highlighted one such case – that of an ex-Treasury adviser who returned to KPMG after advising the Treasury on establishing its 'Patent Box' (tax relief on companies basing research and development initiatives in the UK).[53] This is not to suggest that these advisers have done anything wrong. This practice does however allow for a conflict between commercial and public interests.

Equally concerning, the BEPS working group on digital economy is co-chaired by France and the US. The US has a particular vested interest in this group since it plays host to some of the world's largest global digital companies (including Google, Amazon, Facebook, Apple). These are companies which have been the subject of high-profile public scandals[54] for aggressive tax planning. It is highly likely that the chair of a working group will heavily influence the group's outcomes.

Business interests will also directly influence the position of OECD members. For example, one of the action items under BEPS is the strengthening of controlled foreign company (CFC) rules, which are designed to limit companies' ability to avoid tax by using tax havens. These rules can reduce tax abuse in the country where the company's head office is registered, and when well-designed, can disincentivize those companies from shifting their profits out of other countries in which they operate – often developing countries – and into tax havens. This reduces their profits on paper in these countries, enabling them to pay less tax there.

In the UK in 2012, Treasury changes to CFC rules systematically removed these protections for other countries, and at the same time made it easier for MNCs to shift profits out of the UK. The new loopholes in the UK's CFC rules had been several years in the making, dating back to 2008. The government established a series of liaison groups, consisting of representatives solely from large multinational businesses.[55] It is not unreasonable to assume that these business groups will be lobbying the UK government to resist any strengthening of the CFC rules in the UK or at the OECD.

MOST COUNTRIES DO NOT HAVE AN EQUAL SAY

While G20 action to address corporate profit shifting and base erosion is a step in the right direction, the BEPS Action Plan has an inherent and fundamental flaw: countries that are not members of the OECD and G20 are effectively barred from the process of deciding the new rules. Excluding at least four-fifths of the world's governments from the process of developing a new '*multilateral* instrument' (emphasis added)[56] not only runs the risk of remaining mired in the same power dynamics that have produced the current unfair system, but is also deeply iniquitous. Despite strong evidence that profit shifting occurs *more* in non-OECD countries than in OECD countries,[57] they will not be represented at the negotiating table. As a result, any agreement will inevitably continue to serve the interests of the most powerful and engaged countries.

While global in reach, the final outcomes of the BEPS process will be agreed with non-OECD/G20 countries only being 'consulted' along with other 'stakeholders'.[58] Indeed, the OECD has initiated four regional consultations on BEPS; one in Seoul (for Asian countries), one in Bogotá (for Latin America and the Caribbean), one in Pretoria (for African countries) and one in Paris for African francophone countries. It is not clear how the conclusions from these consultations will be taken on board. Clearly, these regional consultations should not be one-off events. Moreover, these meetings were not representative enough: there were more participants from OECD/G20 countries than non-members at the consultation in Seoul. Poor participation was not due to lack of interest, but limited capacity in terms of human and economic resources and limited budget for travel costs, for example. In a country such as El Salvador, the international tax department is still in its infancy and only has one full member of staff, who is fully occupied with administering new legislation on transfer pricing.

THE PLAN MOSTLY ADDRESSES CONCERNS OF THE MAJOR ECONOMIC POWERS

A further flaw is that the Action Plan on BEPS is too narrow in scope, and concentrates too heavily on rich country interests. The Plan's principal objective is to reduce double non-taxation[59] of MNCs. This is a positive response to help tackle some of the many dubious tax abuse practices, employed by such household names as Apple, Starbucks, Microsoft, Amazon, Google, and Vodafone. The Plan is, however, limited in scope because it does not question or change the underlying principles of the system; it only aims to make the existing rules of that system more effective for developed country interests.

For example, the OECD's discussion draft on 'Transfer Pricing Comparability Data and Developing Countries' is inadequate for developing countries. It does not address the near-total lack of price *comparable*s that are agreed when subsidiaries from developing countries trade internally, within the multinational group.[60]

A further critical issue for developing countries will be to ensure that taxes are paid where profits and value are really generated. They will not benefit from an outcome in the BEPS project that leads to increased tax revenues in the richer countries where MNCs are 'resident', with no new revenues in the countries that provide the 'source' for the profits.

Moreover, OECD members are particularly interested in finding solutions to base erosion and profit shifting in high-technology industries and the digitalized consumer market – which therefore defines a strong focus of the priorities for the overall Action Plan. Indeed, there is a specific action point (Action 1) and working group within the BEPS process on the digital economy.

Problematic sectors central to developing economies include agribusiness, telecommunications, and extractives, to which the Action Plan on BEPS gives scant attention. There is no working group within the BEPS process finding solutions to improve tax collection from extractive industries, despite many developing countries relying heavily on that sector for public revenues.[61] This sector is often heavily under-taxed because of tax exemptions or profit shifting practices.

Finally, many of the solutions to these problems so far proposed by the BEPS process are very technical, and require highly sophisticated and well-resourced legislative administrations, which puts less well-resourced governments at a disadvantage. For example, the discussion draft on 'Preventing the Granting of Treaty Benefits in Inappropriate Circumstances', focused almost exclusively on complex anti-abuse clauses in tax treaties. These are often difficult even for wealthy countries' tax authorities to enforce against MNCs, while ignoring simpler fixes that would allow all countries, including developing countries, to counteract abuse by withholding taxes and other simpler measures.[62]

EXPERIENCE OF OTHER TAX REFORMS

Other ongoing OECD-led tax reforms give reason to suggest that BEPS will not benefit developing countries. For example, outside the BEPS process, the G20 has approved an OECD multilateral standard for the reciprocal sharing of information automatically between tax authorities. While this is a positive step, there is a systemic problem with this standard: as it stands, it will only be used by richer countries. The automatic information exchange (AIE) standard will only benefit countries if they have the administrative capacity and legislative framework to share data with others and meet the requirements of the standard. OECD countries are not yet willing to share data with countries whose tax authorities cannot meet that standard. As a result it will not benefit many developing countries, unless the OECD standard permits those countries to receive information without sending any in return until they develop sufficient administrative capacity to do so, for which they will need support.

To be truly effective, the multilateral standard must also include a robust definition of beneficial ownership, declaring the identity of the individual who ultimately benefits from the income or wealth of the company, bank account, trust or foundation – identities that are currently masked by the creation of 'shell companies' or similar structures. It is essential to establish publicly accessible government registers of beneficial owners of all corporate vehicles, whose public nature will also help those countries which cannot participate in AIE.[63]

Overall, donor countries and relevant international organizations need to commit to a long-term co-ordinated capacity building programme to strengthen tax systems and administrations in developing countries. In 2011, the IMF, OECD, UN and World Bank presented a report entitled 'Supporting the Development of More Effective Tax Systems'[64] to the G20's Development Working Group. In it, they proposed a set of recommendations which, beyond capacity building, included a number of measures to increase tax collection. Sadly, momentum behind the report and its recommendations has since dissipated.

3 DEVELOPING COUNTRIES DESERVE BETTER

In terms of governance, the OECD is only accountable to its members, and its member countries include many of the world's tax havens, which play host to the world's largest MNCs. It is therefore no surprise that the BEPS 'project' reflects their interests. Furthermore, decisions are made by consensus, allowing those governments representing tax haven jurisdictions to undermine any potential reform that goes against their interests.[65]

This begs an obvious question: are the OECD and G20 a sufficiently legitimate and representative body to be deciding on reforms to internationally applicable tax rules? The arguments against are compelling.

For example, even though G20 leaders[66] '…*agreed that multilateralism is of even greater importance in the current climate, and remains our best asset to resolve the global economy's difficulties...',* the BEPS discussions are not a truly multilateral process. The emerging economies in the G20 cannot represent *all* developing countries. Their interests are not the same as all non-G20 countries, since many of their multinational businesses exploit the same loopholes as do companies based in OECD countries.

HOW SHOULD THE BEPS PROCESS BE IMPROVED?

By fully engaging non-G20/non-OECD countries in BEPS decision making

In the immediate term, the OECD and relevant working groups must ensure that non-G20/non-OECD countries are able to participate fully in drawing up any proposed revisions to international tax rules within the BEPS process. They could, for example, link with the UN Committee of Experts on International Cooperation in Tax Matters (known as the UN Tax Committee), who can help facilitate this. The BEPS process must allow sufficient time and resources to enable non-G20/non-OECD countries to be meaningfully involved, even if it requires amending the current breakneck speed of the BEPS timetable.

By working towards a global body to improve governance of international tax

Ultimately, a multilateral institutional framework will be needed to oversee the global governance of international tax matters. Fifteen years ago, Vito Tanzi, former Director of the Fiscal Affairs Department at the IMF, proposed that a new authority be established.[67] The prime objective of this World Tax Authority (WTA) would be 'to make tax systems consistent with the public interest of the whole world rather than the public interest of specific countries'.

While there is clearly still currently a lack of political will for the creation of such a body, a WTA could perform a critical role. It could independently follow global tax developments and gather statistics; be a forum for discussion on international issues related to tax policy; tackle tax competition by setting common minimum tax rates to prevent a ‘race to the bottom’ on corporate taxation; exert peer pressure on countries/jurisdictions that enable companies to be free riders; and develop best practices and codes of conduct on tax-related issues. If a WTA was able to build sufficient trust in its performance and governance over time, its mandate could increase to include the development of mandatory regulations and formal surveillance. Compliance with its rules could be achieved either by establishing an international dispute forum, and/or by making the benefits of any future investment rules agreed at the World Trade Organization (WTO) conditional on a country's compliance with WTA rules.[68]

By taking a different approach to the BEPS Action Plan

As explained earlier, the Action Plan on BEPS is too narrow in scope. A different approach is required if it is to deliver reforms that create an international tax system that is fit for purpose. Specifically:

- All governments must take action to end the ‘race to the bottom’ that encourages developing countries to compete with each other to offer the lowest tax environment, driven by harmful and preferential tax regimes. This includes tackling the role of tax havens. In 1998, the OECD’s Harmful Tax Competition report proposed that ‘countries consider terminating their tax conventions with tax havens’.[69] Unfortunately, OECD member countries that operate as tax havens, together with other powerful members, succeeded in blocking further progress on the report’s findings and recommendations. Within the BEPS process, the OECD’s Forum for Harmful Tax Practices (FHTP) is tasked with examining harmful aspects of OECD members’ own tax regimes.[70] However, the OECD has said that it does not currently intend to publicly consult on or publish the content of this work due to its sensitivity to governments.[71]
- All governments should engage in negotiations about a change to taxation rights, so that foreign businesses pay taxes in the country or jurisdiction where their economic activity and investment is actually located. This requires, in part, the rebalancing of taxing rights between ‘residence’ countries (home recipient of income) and ‘source’ countries (where income is generated).[72] Establishing where companies should be taxed determines the international distribution of the corporate tax base. One of the most practical changes for developing countries would be to *withhold* more tax at source, in the same way that income tax is collected from individuals. This would also be less of an administrative burden for poorer countries than more complex anti-abuse measures.

- All governments should engage in exploring alternatives to taxing companies as branches and subsidiaries, and instead taxing as one multinational group. The OECD's Arm's Length Principle, which is based on comparable market prices that do not really correspond to reality, provides several loopholes through which MNCs avoid tax. Several alternatives to the Arm's Length Principle may provide a better system for developing countries, but further research would be needed to assess their potential impacts. India, China, Brazil, Argentina, and South Africa, for example, have independently put in place alternatives to the Arm's Length Principle, and it would be interesting to consider the impact of these alternatives if other developing countries were to adopt them. Similarly, some academics have proposed another alternative in the form of unitary taxation, whereby an MNC is taxed as one entity, and a formulary apportionment[73] approach is used to share profits. Additional research should be conducted to look at the viability of this method.

4 CONCLUSION AND RECOMMENDATIONS

The broken system that allows MNCs to escape their tax obligations, particularly in poorer countries, can no longer be ignored. It denies governments the vital revenues that are rightfully theirs to spend on essential services and on fulfilling human rights obligations to their citizens. Establishing a progressive tax system in which MNCs pay their fair share is essential to enable governments worldwide to reduce inequality. In the G20 Finance Ministers Communiqué,[74] world leaders committed to 'engage with, and support low-income and developing countries so that they benefit from our work on tax'. This commitment now needs to be translated into actions.

The G20/OECD BEPS project presents a unique opportunity to overhaul international corporate tax rules to deliver more equitable returns for all countries and companies. Currently, however, there is a huge risk that any proposed revisions to the rules will only serve the interests of wealthier and more powerful countries. This opportunity is too rare and important to be squandered. The process must allow sufficient time for the full and meaningful involvement of non-OECD/G20 countries to achieve a more level playing field.

The final goal is to deliver ambitious international tax reforms, where profit shifting will no longer be made possible and profits will be taxed where the substance of economic activity takes place, so that countries' tax base is no longer eroded.

Within the OECD Action Plan on BEPS, G20 and OECD members should:

- Open up negotiations to reform tax rules, so that all countries can participate in the decision making process on an equal footing;
- Promote worldwide tax transparency by requiring MNCs to make country-by-country reports publicly available for each country in which they operate, including a breakdown of their employees, physical assets, sales, profits, and taxes (due and paid), so that there can be an accurate assessment of whether they are paying their fair share of taxes;
- Address other key issues that contribute to tax base erosion and hit developing countries hardest, such as harmful tax competition, changes to the allocation of tax rights (source vs residence principle), and taxation of extractive industries.

As part of the G20 Presidency programme, G20 countries should:

- Request that the OECD report to be delivered in September 2014 to the G20 Development Working Group (on the impact of BEPS in developing countries) be made public and be considered within BEPS negotiations;
- Agree a programme to support the integration of developing countries

to build effective tax systems and better co-ordinate the work between the 'Finance Track' (the G20's co-ordination process for all financial and economic issues, composed of all G20 Finance Ministers and Central Bank Governors) and the Development Working Group of the G20;

- Work with the IMF, World Bank, UN, African Tax Administration Forum, Inter-American Center of Tax Administrations, and other relevant bodies to develop a coherent plan to help developing countries strengthen their fiscal administrations in order to tackle base erosion and profit shifting in the future;
- Implement a multilateral system for exchanging tax information on an automatic basis, which would include developing countries from the start with non-reciprocal commitments (i.e. no obligation to send information until they have established the capacity to do so).

Launch a more comprehensive international tax reform

- **All countries should** promote a proposal to establish a WTA to ensure tax systems deliver for the public interests of *all* countries. A WTA could independently follow global tax developments and gather statistics; be a forum for discussion on international issues related to tax policy; tackle tax competition by setting common minimum tax rates to prevent a 'race to the bottom' on corporate taxation; exert peer pressure on countries/jurisdictions that enable companies to be free riders; and develop best practices and codes of conduct on tax-related issues.
- **The WB and IMF should** host a joint agencies' meeting to reanimate the 2010 G20 Seoul initiative that led to the joint agencies' recommendations on supporting the development of more effective tax systems,[75] and agree on a plan to help developing countries build effective tax systems that will lead to better global governance of international taxation.
- **The IMF should** conduct research on possible alternatives to the OECD's Arm's Length Principle, such as unitary taxation, and their impact on base erosion and profit shifting in developing countries.
- **All governments, but developed country governments in particular, should** give financial support to the UN Tax Committee to facilitate innovative discussions on topics including changes to the allocation taxation rights of companies, and explore alternatives to the Arm's Length Principle.
- **All governments and tax policy-making bodies** should introduce and abide by a code of conduct that ensures that businesses and accountancy firms, and their personnel, avoid any conflicts of interests when being paid or hired by decision makers to 'provide intelligence and innovation', and ensure that commercial interests do not take precedence over the interests of the public.

NOTES

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11 A company's headquarters is often tax-resident in one place and registered in another, for example, e.g. the UK FTSE100 company WPP: parent company registered in Jersey, tax-resident in the UK.

12 See UK Parliament, Public Accounts Committee inquiry, HM Revenue and Customs Annual Report and Accounts, Inquiry Tax Avoidance by Multinational Companies, November 2012 http://www.publications.parliament.uk/pa/cm201213/cmselect/cmpubacc/716/71605.htm

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The OECD identified tax havens as a harmful form of tax competition because they 'poach' the tax base of other countries by providing an accommodating tax and legislative framework for essentially fictitious activities. Tax havens also spur on the battle for lower tax rates between countries, by offering foreign-owned capital a low or no tax alternative.

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