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CBI
THE VOICE OF BUSINESS

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CBI RESPONSE TO THE CONSULTATION ON ECONOMIC "SPILLOVERS" IN INTERNATIONAL TAXATION

1 The CBI is pleased to comment on the IMF's consultation on Economic "Spillovers" in International Taxation ('the consultation') published on 14 February 2014. We have also used this as an opportunity to provide comments on the IMF's paper "Issues in international taxation and the role of the IMF" ('the paper').

2 As the UK's leading business organisation, the CBI speaks for some 240,000 businesses that together employ around a third of the private sector workforce, covering the full spectrum of business interests both by sector and by size.

Comments on IMF paper "Issues in international taxation and the role of the IMF"

3 The CBI considers that that the assumption made in paragraph 4 of the paper, i.e. that much of the benefit of tax avoidance by multinational corporations (MNCs) goes to the better off, is incorrect. There are numerous studies that show that corporate income taxation has negative effects on an economic growth. I.e. every $ paid in tax is a $ less that is available to either pay employees, make investments for the future, or to return to shareholders. In most cases the shareholders are financial institutions that are investing for the benefit of many individuals, mainly for retirement provision. Some of the biggest pension funds like CALPERS are for the benefit of public sector employees. We would expect that these are not the people that the IMF refers to as the "better off".

4 Studies also show that the global inequality is increasing and the global recession and loose monetary policy that has followed it has most likely exacerbated this inequality. However, the CBI considers that it is a leap too far to conflate this issue with an assertion that the "better off" benefit the most from MNCs' tax planning.

5 With regards to paragraph 5, Box 1 of the paper, we note that provision of services or management of intellectual property from a low tax jurisdiction is consistent with the G20 Communique of 23 February 2014, which states that "profits should be taxed where economic activities deriving the profits are performed and where value is created". Although later in the paper, the issue of tax competition and the fact that some countries choose to be low tax is being discussed, it should be noted that this is a matter for sovereign governments – an MNC merely responds to the tax environment that countries choose to operate. We believe that in a similar way that tax systems are being used to encourage individuals to save for their retirement, tax systems can also be used to encourage investment by MNCs.

6 A further comment on Box 1 relates to the fact that an MNC may take a deduction in a high tax country and recognise income in a low tax country (the example given is intragroup debt finance). The

other side of the coin is where a country chooses to deny a tax deduction for a legitimate business expense, thus subjecting an MNC to double taxation. A list of examples to illustrate such cases is endless: an expense paid to an affiliate, a cap on certain types of expenditure like advertising, an arbitrary limit on the amount of a royalty, the imposition of additional taxes that result in a cross border charge being more expensive than that of a domestic supplier etc. The CBI would encourage the IMF to also review the spillover effects caused by these types of choices made by countries.

7 Regarding paragraph 14 of the paper, we note that tax rates are only one factor in the investment decisions that a company makes. A stability and the rule of law would almost certainly be more important considerations than a tax rate. Furthermore, we believe that a comment at the end of paragraph 14, that territorial tax systems may face increased pressure to offer incentives, is arguable. For example, let us assume that a host country has a tax rate of 20% and the home country has a tax rate of 20%. Under a credit system, the taxpayer would suffer tax at 20% borne in the host country. Under a territorial system, the taxpayer would suffer tax at 20% also borne in the host country. Instead, let us assume that the host country has a tax rate of 30% and the home country has a tax rate of 20%. The taxpayer would suffer tax at 30% under both systems and it is not clear to us why the host country would be under pressure to reduce its tax rate from 30% to 20%?

8 With regards to the "Areas for future work" set out in the paper, we are concerned that the IMF may miss a real opportunity here. If one assumes that MNCs are not engaging in clever tricks, and that taxable income arises where the economic activity takes place and the value is created (as per G20 Communique), the position of developing countries would be most improved by them becoming attractive places in which MNCs choose to locate their economic activity.

9 This will not happen, however, if developing countries focus merely on raising revenue in the short term by tapping MNCs (who are generally the most tax compliant taxpayers), instead of taking the necessary steps to broaden their tax compliance base.

10 Finally, with regards to the OECD BEPS work, we believe that there are four areas which BEPS project is failing to address:

i) When does sovereign tax policy become harmful tax practice?
ii) Is one country's view of value creation the same as another country's view of value creation?
iii) In allocating taxable income, what is the relative importance of labour versus capital?
iv) Does "fair share" really mean more corporate income tax revenues for every country, in other words not just eliminating double non-taxation?

11 In the paper, the IMF discusses item i). However, the paper does not address the remaining three items which will, almost certainly, have spillover effects. In particular, we believe that the IMF, given its economic and technical tax expertise, would be uniquely well placed to consider item iii). For example, if one considers countries where an access to capital is highly controlled by the state or which has a large percentage of economic activity de facto managed by the state (e.g. China, the Middle East or Russia) versus a more typical OECD country, then the relative value placed on access to financial capital may be very different. How does that distort economic activity and the competitiveness of MNCs?

Comments on specific questions of the consultation

Do you have views on the potential outcomes of an adoption of formulary apportionment and/or unitary taxation—of some degree (including, for example, some form of 'residual profit split')—for developing countries? Other countries? International business? If you support such a system, what allocation factors would you suggest?

12 We do not believe that formulary apportionment is a viable solution (see CBI report "Tax in a global economy: the way forward"[1]). In particular, not just for developing countries. One of the main purposes of the OECD BEPS project is to arrive at a methodology that retains the arm's length principle while moving to an allocation basis that allows more profit to be recognised in developing countries. Any hybrid approach is bound to result in double taxation. Furthermore, the MAP process, where it is available, would be overloaded as it is unlikely that a country with an arm's length

[1] http://www.cbi.org.uk/media/2155378/cbi_tax_landscape_report_embargoed_18_july_2013.pdf

approach would be able to reach an agreement with one using formulary apportionment. A mandatory MAP would be critical here, as with BEPS.

How should the international tax architecture treat jurisdictions where significant corporate profits are booked, but which have relatively little substantive economic activity?

13 We believe that taxation approach based on risks and functions is the right one, and the OECD's move towards more recognition of the role of people seems to accommodate any concerns as to whether this can be dealt with by tax authorities. Such approach is likely to achieve a result which is essentially one of substance.

14 Furthermore, proposals around country-by-country reporting for tax would provide information on the supply chain and other activities such as financing in order for tax authorities to conduct an audit. We believe that no further action is required here. The real challenge is agreeing on an appropriate return for in-country risks and functions (subject to a mandatory MAP to prevent double taxation) and upskilling tax authorities where this is needed. Beyond that, we believe that the risk of an economic double taxation is much higher than economic non-taxation.