ActionAid International welcomes this effort to consolidate the views of a diverse range of stakeholders on the state of corporate taxation around the world. We appreciate the potential that this process has to challenge the current state of the international corporate tax system and look forward to the outcome.

Declining Corporate Tax Rates

We are deeply concerned by the race to the bottom in statutory corporate tax rates, particularly in the OECD countries, intensifying in the last two years. It adds to a number of existing challenges for effective taxation of multinational corporations and ensuring efficient and progressive national tax systems.

In 2018, a majority of OECD jurisdictions' tax reforms included the reduction of tax rates on businesses and individuals with the apparent objectives of boosting investment, consumption and labor market participation.[1] In December 2017, the US Tax Cuts and Jobs Act (TCJA) reduced the statutory corporate tax rate from 35% to 21%, placing the US rate below the average for most other OECD countries, Belgium followed suit by introducing a tax reform package that will progressively reduce the Corporate Income Tax (CIT) rate from 33.99% to 25% by 2020.[2] In 2018, Luxembourg, Japan and Norway reduced their statutory CIT rates, whilst the UK and Greece announced their intention to reduce their CIT rates by 2020.[3] According to the OECD, CIT rate levels have decreased amongst almost all member and partner jurisdictions with the exception of Chile.[4] Six jurisdictions reviewed by the OECD in 2000 had CIT rates of 25% or less; this year, the figure increased to 38.[5]

In developing countries, the race to the bottom has been largely characterized by the granting of tax incentives to secure Foreign Direct Investment (FDI), resulting in lower effective tax rates for MNCs. Tax incentives give rise to opportunities for tax avoidance and abuse, common abuses include existing firms transforming into new entities to qualify for incentives, domestic firms restructuring as foreign investors, overvaluation of assets or the creation of fictitious investments.[6] The widespread use of tax incentives granted under special regimes has brought the effective tax rates close to zero in many sub-Saharan African countries.[7] Overgenerous or poorly designed incentives can result in foregoing revenue without generating commensurate value in the form of investments.[8] Tax incentives can be even more ineffective in environments where factors essential to the ease of doing business such as electricity, sanitation, a well educated labor force, security and accessible quality healthcare are underfunded.[9]

While we appreciate the IMF raising warning flags around the problem of competition on rates and incentives, we are concerned by little-to-no action or often even recognition by other key global institutions reuniting high income countries leading this race, including the G20 and the OECD. The OECD referred to

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[1] OECD (2018), *Tax Policy Reforms 2018*: *OECD and Selected Partner Economies*, OECD Publishing [online]. Available at: https://read.oecd-ilibrary.org/taxation/tax-policy-reforms-2018_9789264304468-en#page10 (Accessed November 2018), 9.

[2] See *Supra* note 1, 66

[3] *Ibid.*

[4] See *Supra* note 1, 66

[5] *Ibid.*

[6] UN (2018), *Design and Assessment of Tax Incentives in Developing Countries: Selected Issues and A Country Experience*, UN and CIAT [online]. Available at: https://www.un.org/esa/ffd/wp-content/uploads/2018/02/tax-incentives_eng.pdf (Accessed November 2018), 238

[7] Abbas, S.M. Ali & Alexander Klemm *et al* (2012), *A Partial Race to the Bottom: Corporate Tax Developments in the Emerging and Developing Economies*, IMF WP/12/28, 21 – 22.

[8] Forstater, Maya (2017), *'The Good, The Bad and The Ugly: How Do Tax Incentives Impact Investment?'* Center for Global Development [online]. Available at: https://www.cgdev.org/blog/good-bad-and-ugly-how-do-tax-incentives-impact-investment (Accessed December 2018)

[9] *Ibid*

this problem as a "race to the average"[10] and justified this assertion by stating that the countries that introduced corporate tax rate cuts in 2018 included those that had the highest rates in 2017.[11] Tax incentives such as tax holidays continue to erode the revenue potential of corporate taxation; governments need to be further supported, or pressured, to assess their incentives and curtail those that are unnecessary and shrink the tax base.

While the trend of declining CIT rates is not yet as clear in developing countries, it seems nearly inevitable that they will follow suit, a move which would hurt them even more than rich countries, as their dependence on CIT is greater. In a report published in 2017, the European Network on Debt and Development (Eurodad) estimated that, based on developments between 1980 and 2015, the global average corporate tax rate will hit zero per cent in 2052.[12] Reducing CIT rates means that consumers will have to pay more in order to fill the gap and this is likely to disproportionately affect the poorest and exacerbate inequality rather than reduce it.[13] Tax competition is continuing to intensify and without any changes to the global tax architecture, this is unlikely to change.

Advocacy for the elimination of the CIT does not take into account the resulting impact on revenue raising. The Tax Justice Network's Ten Reasons to Defend the CIT report[14] highlights the potential for individuals to use companies to stash their money away and defer or escape tax. ActionAid International strongly discourages any calls for the elimination of the CIT particularly in view of its importance for developing countries.

OECD's Base Erosion & Profit Shifting (BEPS) process

Like many other civil society organizations, ActionAid International feels that the lack of full participation by developing countries in the BEPS process fatally undermines it. The failure to factor in developing countries' needs during the development of the BEPS Action Plans has inevitably had negative consequences for the content of the recommendations, which largely respond to the concerns and capacities of developed nations.[15] The BEPS Action Plan has been widely criticized for embodying rules set by a few countries and thereby reinforcing a system that exacerbates global inequality.[16]

The Action Plan, for instance, does not address one of the fundamental principles of the international tax system, the allocation of taxing rights and income between residence and source countries. The OECD has, in the past, determined that the concern with the allocation of taxing rights within DTTs is not a tax planning/avoidance issue, does not give rise to BEPS and is not within the scope of the BEPS Project.[17] This has meant that despite extensive work on some aspects of tax treaties under the BEPS project, tax allocation models have remained the same[18], denying developing countries increased rights to tax and raise

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[10] See *Supra* note 1

[11] See *Supra* note 1

[12] Eurodad *et al.* (2017), *Tax Games: The Race to the Bottom, Europe's Role in Supporting an Unjust Global Tax System*, Eurodad, 4.

[13] *Ibid.*

[14] Shakxon, Nick (2015), *'New Report: Ten Reasons to Defend the Corporate Income Tax',* Tax Justice Network [online]. Available at: https://www.taxjustice.net/2015/03/18/new-report-ten-reasons-to-defend-the-corporate-income-tax/ (Accessed December 2018)

[15] *Ibid.*

[16] Oguttu, Annet (2016), *Tax Base Erosion and Profit Shifting in Africa – Part 1: Africa's Response to the OECD BEPS Action Plan*, ICTD Working Paper 54, 20.

[17] OECD (2014), *Part 1 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries*, OECD [online]. Available at: www.oecd.org/tax/tax-global/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf (Accessed November 2018), 9.

[18] ActionAid (2015), *Patching up a Broken Tax System: Why BEPS is not the Solution to Poor Countries' Tax Problems*, Actionaid [online]. Available at: http://www.actionaid.org/publications/patching-broken-tax-system-why-beps-not-solution-poor-countries-tax-problems (Accessed November 2018).

revenue and introducing more complex standards for nations already struggling with administrative capacity. For instance, since model tax conventions prioritize residence as a determinant of tax liability, the application of the source principle is anchored on the concept of permanent establishment or will be realized through the application of withholding taxes on interest, royalties or dividends. Whilst additions have been made to expand the activities that qualify as permanent establishment, the basic concept remains the same and this means that corporate residence can still be engineered. In addition, the OECD have made little effort to deal with the withholding tax regimes in tax treaties.

Action 5 of the BEPS Action Plan on countering harmful tax practices has been largely ineffective in preventing the spillover effects of preferential tax regimes. The Forum on Harmful Tax Practices (FHTP) has accepted several intellectual property (IP) regimes, such as those of Singapore and Luxembourg, amongst others, as not being harmful.[19] In addition, headquarter regimes including pioneer service companies in Singapore and the global headquarters administration regime in Mauritius have been accepted as not harmful.[20] The Mauritian regime, referred to as the Global Headquarters Administration License, offers companies an 8-year tax holiday.[21] As a key investment hub for Africa, Mauritius has entered into favorable tax treaties with many African countries.[22] Some of these treaties have been evaluated by the IMF and have been found that to trigger re-routing of investment and income flows and to potentially increase incentives for profit shifting rather than increasing overall investments made.[23]

Not only is the Mauritius regime a clear example of a system that will give rise to treaty abuse, but it is also an indication of the far-too-limited scope of the BEPS project to prevent tax avoidance. Monitoring the implementation and impact of the BEPS measures, particularly the minimum standards, has been compromised by the fact that the recommendations of the Action Plan are skewed to the needs of developed countries. Whilst the work done so far is, to a limited extent, commendable, neither BEPS nor the Inclusive Framework have really dealt with the challenges faced by developing countries. The shortcomings of the IF demonstrate only more clearly the dire need for more effective and inclusive global tax governance, ideally established under the auspices of the UN.

To begin responding more effectively to harmful tax practices, countries – and High Income Countries in particular - should begin with an evaluation of the spillover effects of their tax systems[24]. Understanding and addressing tax spillovers is key to fair and responsible tax policies and the delivery of the Policy Coherence for Development commitment made under SDG 17, the Addis Tax Initiative[25] and – for the EU Member States – enshrined in the TFEU[26].Tax spillovers are sizeable, particularly for developing countries, so in order for wealthy countries to make informed policy choices, international organizations must encourage them to analyse their tax policies with the objective of understanding the extra-territorial effects.[27]

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[19] See The Inclusive Framework on BEPS Action 5 update for November 2018, Available at: http://www.oecd.org/tax/beps/update-harmful-tax-practices-2017-progress-report-on-preferential-regimes.pdf

[20] *Ibid.*

[21] For more information on this see: http://www.mauritiusifc.mu/en/news/budget-2016-2017-main-implications-for-mauritius-ifc/

[22] Beer, Sebastian and Jan Loeprick (2018), *The Cost and Benefits of Tax Treaties with Investment Hubs: Findings from Sub-Saharan Africa*, IMF Working Paper WP/18/227, 4.

[23] *Ibid,* 5.

[24] See Baker, Andrew & Richard Murphy (2018), *Tax Spillovers: The Assessment Procedure*, University of London and Sheffield Political Economy Research Institute.

[25] Addis Tax Initiative Declaration: https://www.addistaxinitiative.net/documents/Addis-Tax-Initiative_Declaration_EN.pdf

[26] Treaty on the Functioning of the European Union: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=celex%3A12012E%2FTXT

[27] *Ibid*

Efforts to address the challenges of transfer pricing through the evaluation of value creation, whilst useful for source countries enforcing their right to tax income that has been shifted through transfer mis-pricing, are unsatisfactory. The arm's length principle (ALP) has proven to be burdensome and ineffective, in particular in developing countries' context. The underlying problem – the incompatibility of the ALP with the reality of global economy – has not been addressed by the BEPS project, despite broad-based critiques of it from many sources, including the Independent Commission for the Reform of International Corporate Taxation (ICRICT).[28] In order to effectively tackle the problem of transfer pricing abuses and many other tax avoidance practices, a new approach to corporate taxation is needed and unitary taxation proposals such as those made by ICRICT should be further explored and developed.[29]

The Multilateral Insrument (MLI) has the potential to improve a number of provisions in existing treaties, however, uncertainty remains about its impact and interpretation going forward. Our two main concerns are the risk of countries opting out of the useful provisions, which would undermine the effectiveness of the convention and the provisions on dispute resolution and mandatory binding arbitration. Because of the construction of the panel and expenses involved, mandatory arbitration risks discouraging countries from fully enforcing their taxing rights.[30] In addition, we are concerned about the arbitration proceedings being confidential and that none of the evidence produced would be made public. ActionAid International is currently advising developing countries to opt out of the dispute resolution and mandatory binding arbitration clause. However, efforts should be made to revise this provision.

The state of the international corporate tax system after BEPS has only marginally advanced. Developing countries continue to deal with the challenge of claiming and enforcing their taxing rights and their efforts have been undermined by the failure of BEPS and other processes to address the weaknesses of the principles of international taxation that are fundamentally skewed in favor of developed countries.

In light of this situation, we expect that developing countries will begin to adopt unilateral solutions to the problem of BEPS. Regional cooperation amongst developing countries is also expected to increase. For instance, in Africa, the regional economic communities are developing model treaties and otherwise increasing tax cooperation. This may have positive outcomes for the countries concerned, but it could also lead to further fragmentation in international taxation, opening up new mismatches. This further demonstrates the need for a more effective and inclusive global tax governance, which would respond to the needs and concerns of all countries. We strongly support the move for a UN convention on tax.[31]

Unitary Taxation

We strongly believe that the ineffective ALP approach must be replaced with unitary taxation using formulary apportionment, which is likely to be more effective in ensuring fair and effective international corporate taxation, if properly designed. A formulary approach should apportion MNCs' income to the different jurisdictions based on objectively verifiable factors such as employment, sales, resources used, fixed assets or any other factors that reflect real economic activity.[32] However, a suitable formula must respond to the different types and needs of economies, and be negotiated in an inclusive process, where

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[28] ICRICT, *A Fairer Future for Global Taxation: A Roadmap to Improve Rules for Taxing Multinationals.* https://static1.squarespace.com/static/5a0c602bf43b5594845abb81/t/5a78e6909140b73efc08eab6/1517872798080/ICRICT+Unitary+Taxation+Eng+Feb2018.pdf

[29] *Ibid*

[30] ActionAid (2017), *Briefing on the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, ActionAid [online]. Available at: http://www.actionaid.org/publications/actionaid-briefing-multilateral-convention-implement-tax-treaty-related-measures-preven (Accessed November 2018), 3.

[31] Eurodad (2016), *An Intergovernmental UN Tax Body – Why We Need it and How We Can Get It,* Eurodad [online]. Available at: https://eurodad.org/Entries/view/1546626/2016/08/29/An-Intergovernmental-UN-Tax-Body-why-we-need-it-and-how-we-can-get-it (Accessed December 2018)

[32] Independent Commission for the Reform of International Corporate Taxation (2018), *A Roadmap to Improve Rules for Taxing Multinationals*, ICRICT.

developing and developed countries participate on an equal footing. To counter the potential for countries to engage in a race to the bottom on corporate tax rates, formulary apportionment should be accompanied by an agreed minimum rate for taxing all apportioned profits.[33] This type of system can ensure that source countries, where economic activity takes place, receive their fair share of tax.

For formulary apportionment to be effectively implemented, countries will need to ensure that companies cannot manipulate the factor adopted to determine allocation (sales, employees, fixed assets etc.) by requiring an evaluation of the economic activity being undertaken and the type of assets utilized and their value relative to the value of the overall group of entities. This is a priority for developing countries where the application of ALP to management and technical services has been highly susceptible to MNCs introducing additional costs to the base price that cannot be justified by commensurate value. Whilst this can be mitigated through effective exchange of information, global structures must ensure that systems remain accessible and easy to use for developing countries' revenue administrations.

Digital Taxation

In an era where capital has become highly mobile and the digital economy has facilitated business in a number of jurisdictions without establishing a taxable presence or permanent establishment, the destination principle has been useful in developing an indirect tax on consumption. For instance, India introduced the equalization levy in June 2016 requiring that Indian taxpayers withhold 6% of any payments made to non-residents for online advertising services. However, this type of tax may result in a heavy enforcement burden due to a high risk of non-compliance.

The proposal for a destination-based corporate tax eliminates the concept of corporate residence as a determinant of tax liability. It also provides for an opportunity to establish nexus based on the location of users/customers who either purchase items or significantly increase the value of the platform by providing data. Determining the value of transactions based on the number of users or collection of data from those users could be a good way to realize the concept of economic substance. But this initiative will probably be characterized by significant complexity in its implementation. Revenue administrators in developing countries, in particular, may not currently have the capacity to access the data required to determine appropriate thresholds and whether a company may create significant economic presence. This challenge must be dealt with in order to ensure that taxing rights are not skewed to developed countries which have greater capacity. The use of the destination principle should be limited to the digital economy as it could create new problems if applied in other sectors.

Digitalization of the economy has contributed to increased international corporate tax avoidance. It has weakened the link between business activity and the actual physical presence of a MNC.[34] Significant features of the digital economy have not been captured by the international tax architecture including value creation by prosumers and data related to users.[35] Whilst the OECD is in the process of developing new approaches to taxing the digital economy, there remains a concern that developing countries will not be included in this process. Efforts to address the digital economy should ensure that developing countries are meaningfully engaged in the process of identifying their needs and that all features of the digital economy are considered. Global cooperation on the development of taxation of the digital economy standards should be inclusive and permit full and equal participation of developing countries; for this reason the UN is the ideal institution to address global issues of common concern.[36]

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[33] *Ibid*

[34] Tax Justice Europe (2018), *'Tax Justice Europe Position: Taxation of the Digital Economy'*, TJE, 1.

[35] *Ibid*

[36] ICRICT (2018), *A Fairer Future for Global Taxation*, ICRICT. Available at: https://static1.squarespace.com/static/5a0c602bf43b5594845abb81/t/5a78e6909140b73efc08eab6/1517872798080/ICRICT+Unitary+Taxation+Eng+Feb2018.pdf

The process of addressing the taxation of the digital economy must be focused on taxing the income earned by MNCs and not individuals who have already incurred greater effective tax liabilities in the past. In addition, in view of the advancements in developing countries, taxing the digital economy should also be addressed from a human rights perspective. In 2018, Uganda opted to introduce a social media tax which is levied daily on individuals who use online services including Facebook, Twitter, Skype and Whatsapp. During the period of implementation, the President of Uganda commented that the tax was being introduced to regulate online gossip or idle talk – which has been interpreted as censorship.[37] Taxpayers in Uganda have either decreased their usage of the platforms or have turned to Virtual Private Networks (VPN) to avoid paying the tax.[38] Taxation can be used as a tool of authoritarianism and it is important to acknowledge that efforts to raise revenue should not conflict with the fundamental respect for human rights. The OECD and other bodies concerned with influencing tax policy making on the digital economy should emphasize that recommended methods of taxing the digital economy do not infringe upon the civic space or place an unfair burden on consumers whilst failing to tax the companies that earn significant income.

Conclusion

Current arrangements for international tax cooperation are not adequate. With governments seeking to maximize their national interests, competition to attract investments, resident taxpayers and tax revenue is difficult to curtail. In a free market where MNCs now hold greater negotiating power than many governments, the space for influencing international tax cooperation has been dominated by those with interests at odds with the general welfare.

The efforts undertaken to realize global coordination via the BEPS Project, have been reactionary in nature and merely proposed amendments to existing rules rather than address the need to reformulate weak underlying principles. This has given rise to countries developing new and advanced techniques to provide competitive regimes that fly under the radar of what is currently recognized as giving rise to BEPS. The remedies proposed more effectively respond to the needs of developed countries, whilst only marginally addressing those of developing countries. The standards under the current international tax architecture do not effectively ensure that companies are paying their fair share; they have yet to shift the burden from the poorest to address inequality, and they do not fairly allocate taxing rights to developing countries that continue to grapple with the race to the bottom.

[37] Kuchler, Hannah (2018), *'A Social Media Tax, Freedom of Speech and Uganda',* Financial Times [online]. Available at: https://www.ft.com/content/1dc7f8f8-8ece-11e8-bb8f-a6a2f7bca546 (Accessed November 2018).

[38] See Nanfuka, Juliet (2018), *'Uganda Blocks Access to Social Media, VPNs and Dating Sites as New Tax Takes Effect'*, CIPESA [online]. Available at: https://cipesa.org/2018/07/uganda-blocks-access-to-social-media-vpns-and-dating-sites-as-new-tax-takes-effect/ & Baliboola, Ivan N. (2018), *'How Uganda's Social Media Tax is Choking Communication'*, New Vision [online]. Available at: https://www.newvision.co.ug/new_vision/news/1485658/ugandan-social-media-tax-choking-communication

The **BEPS** Monitoring Group

Submission to the International Monetary Fund

ANALYSIS OF INTERNATIONAL CORPORATE TAXATION

These comments have been prepared by the BEPS Monitoring Group (BMG). The BMG is a network of experts on various aspects of international tax, set up by a number of civil society organizations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. These comments have not been approved in advance by these organizations, which do not necessarily accept every detail or specific point made here, but they support the work of the BMG and endorse its general perspectives. They have been drafted by Sol Picciotto, with contributions from Jeffery Kadet and comments from Tommaso Faccio, Tatiana Falcao and Suranjali Tandon.

We appreciate the opportunity to provide these comments and are happy for them to be published.

December 2018

SUMMARY

Following the excellent *Spillovers* report of 2014 further evidence has shown the revenue losses due to inadequate coordination of international tax rules, impacting more heavily on poorer countries. These also result from unilateral measures by states to protect their tax bases, the proliferation of which demonstrates that the G20/OECD project on base erosion and profit shifting (BEPS) has inadequately patched up the existing system. In addition to the macro-economic analysis of the welfare effects, we suggest that the IMF consider the micro-economic aspects of aggressive tax avoidance, notably abuse of dominant position and rent-seeking resulting from corporate concentration, and the encouragement to profit-shifting from the shift to hybrid territorial tax systems and from equity-based remuneration of senior corporate managers.

The BEPS project has so far failed to ensure that the profits of multinational enterprises (MNEs) are allocated to and taxed in source countries where their economic activities occur, and value is created. Although there have been extensive revisions of the rules on transfer pricing, this has made them even more complex and difficult to apply, because they still rest on the fictional underlying principle that members of a corporate group are independent entities dealing with each other at arm's length, despite being under common ownership and

centralised control. This approach entails detailed individual analysis of each taxpayer requiring specialist knowledge of its economic sector and business model, creating information asymmetries and an enormous administrative burden for tax administrations, especially in poor countries. Its subjective nature also creates conflict and uncertainty, instead of the predictability needed for decision-making by business.

What is required is a shift towards treating MNEs in accordance with the economic reality that a large part of these profits result from the economies of scale and scope and the synergies due to operating as unitary firms under centralised strategic direction. Three main approaches to unitary taxation have been proposed: residence-based worldwide taxation, a destination-based cash-flow tax, and formulary apportionment. We concur with the report of the Independent Commission on the Reform of International Corporate Taxation (ICRICT) that formulary apportionment is the best of these solutions.

We recognise that moving towards formulary apportionment will take time and needs preparation. A pragmatic approach towards such a system could be developed by building on the profit split method. This can be done by formulating standardised concrete allocation keys and weightings for common business models and industry sectors, refining and elaborating on the generic factors which generate profits: people, capital assets and sales. We urge the IMF, in conjunction with other relevant global and regional bodies, to devote serious resources to examination of this way forward.

1. Relevance and Importance of the Issue

The reform of international corporate taxation has in recent years jumped to a high place in the global policy agenda. This is due to several factors.

A significant concern is of course the government revenue losses due to inadequacies in international coordination of tax rules. These were highlighted and analysed in the 2014 paper on *Spillovers in International Corporate Taxation* (IMF 2014). As that paper showed, these revenue losses impact more heavily on low-income countries. A more recent research survey has highlighted further evidence that less developed countries are more heavily affected by cross-border profit-shifting.[1]

That paper further suggests that there are also spillover effects from anti-avoidance measures taken by states, which magnify distortions in capital allocation and hence produce some negative welfare effects. This is of particular concern in the current period, since many states are introducing unilateral measures to counter avoidance. This is because the G20/OECD project on base erosion and profit shifting (BEPS) resulted mainly in recommendations to patch up existing rules and has failed to tackle the central challenge of agreeing criteria for allocating profits according to where real economic activities take place. This demonstrates the urgent need for greatly improved coordination of international corporate tax rules, particularly from the perspective of the development of the poorest countries, as well as the world economy as a whole.

The 2014 *Spillovers* report also briefly examined some wider welfare implications of spillovers, essentially from a macro-economic perspective. In our view, however, it is also important to analyse the micro-economic effects on firm strategies and particularly on competition and corporate concentration.

Much of the international tax avoidance by multinational enterprises (MNEs) results from their exploitation of flaws in international tax rules. These were originally formulated nearly

[1] S. Beer, R. A. de Mooij and S. Liu, ‘International Corporate Tax Avoidance: A Review of the Channels, Magnitudes, and Blind Spots’, IMF Working Paper No. 18/168.

a century ago, when international investment was mainly of portfolio investment, and MNEs, partly due to the slow communications of the time, operated through local subsidiaries that had their own independent managements (i.e. local CEO, local sales and operations management, local treasury and accounting functions, etc.). With the rise of today's communication technologies allowing true central management of local operations, most MNEs have adopted centrally-managed business models and operate as unitary worldwide businesses.

The rules in place for the past century that allocate taxing rights between residence and source countries distinguish between passive and active income. These rules also adopted the 'arm's length principle' (ALP), which requires MNE group members to be treated as if they were independent entities. This may have been appropriate years ago when local group member subsidiaries did operate independently. Today, however, applying the ALP to the bulk of MNEs and their centrally-managed business models is no longer appropriate and only leads to BEPS motivation and a lack of any reasonably alignment of the allocation of income with the economic activity that generates that income.

Continuing to apply this outdated approach has created an incentive for aggressive tax planning by MNEs through the use of complex corporate structures. These are generally based on attributing control over functions which can be claimed to be high-value-adding, such as research and development, risk and finance, to entities in low-tax jurisdictions. Furthermore, tax competition has led not only to incentives for inward investment, but also to the home countries of MNEs weakening their rules on controlled foreign corporations, which were originally aimed at ensuring taxation of their worldwide profits. These factors have resulted in low effective tax rates on MNEs' source country profits, giving them a strong competitive advantage over local firms.

Hence, the opportunities for international tax avoidance have greatly contributed to distortions of competition and the domination of key economic sectors by the largest MNEs. Corporate concentration results from the ability to benefit from economies of scale and scope, and the advantages of synergy. Increased international economic integration enables MNEs to exploit these on a global scale. In addition, however, they can exploit differences in regulation or regulatory arbitrage, due to inadequate regulatory coordination between states. This importantly includes tax avoidance, which has a direct effect on a company's bottom line. Countering with the anti-competitive effects of corporate concentration, which include abuse of dominant position and rent-seeking, poses important challenges. However, these cannot adequately be dealt with through anti-trust or competition law alone. Indeed, these instruments are often inappropriate and ineffective in regulating the negative effects of corporate concentration. Hence, it is important to remove these inappropriate advantages by improving regulatory coordination between states, to match the level of economic liberalisation that has so encouraged concentration.

The effects on corporate concentration can be seen especially in the fastest-growing business models, those exploiting the digitalisation of business activities. The work on Action 1 of the BEPS Action Plan of the Task Force on the Digital Economy has shown how digitalisation permeates the whole economy and has exacerbated the problems caused by the flaws in international tax rules. Features of the digitalised economy such as network effects further contribute to concentration, while multi-sided business models give further advantages to MNEs.[2]

Central to digitalisation also is the development and exploitation of intangibles, especially software. However, it should be made clear that the problems do not arise from the exploitation of intangibles in itself, but in the ways this has been done in some business models. Developers of business-enhancing software can easily access global markets through licensing, taxation of which can adequately be dealt with without any major reform of existing tax rules. The problems have been caused by deploying such software to build MNEs which have become dominant in various business sectors, such as retailing, tourist accommodation and taxi services. Local firms in these sectors evidently could benefit from digitalisation and access to superior software, but their ability to do so is hampered by the direct competition from these MNEs. Local software developers equally are disadvantaged by the competition from the integrated business models of the MNEs.

For example, Uber has built a significant presence around the world, including in many developing countries. It competes not only with local taxi firms, but also with software developers offering applications or platforms which drivers can use. Normal competition would be healthy, but such firms cannot exploit the same tax avoidance opportunities. The anomaly is that the drivers, as well as local software firms attempting to compete with Uber, are taxed, while Uber's revenues are untaxed in the source country, and Uber can benefit from a low effective tax rate on its global income. Ironically, Uber is willing to cooperate with revenue authorities by supplying them directly with data on the earnings of drivers using its application, to ensure they can be taxed effectively. Yet Uber's own revenues remain outside the nets of the tax authorities of the countries in which it does such lucrative business. Reform of international tax rules to ensure that the income of such firms can be taxed where their activities take place is essential in order to create a level playing field for local business and entrepreneurs.

We would also point to two additional features of today's international tax environment that produce perverted incentives and hence distortions of capital allocation. These may provide the IMF with additional areas in which to conduct research contributing to positive change.

First, home-country tax systems have come to create negative spillovers. Under the hybrid territorial tax systems adopted in past decades by so many countries, the profits earned within specified legal entities and sometimes branches established outside an MNE's home country will either not be currently taxed or will never be taxed by that home country. This *systemically* motivates MNEs to shift operations and profits outside their home countries. The worldwide residence-based taxation system and the unitary taxation system, both of which are mentioned below in section 3, would fully eliminate this systemic issue.

Secondly, the extensive use of equity-based compensation incentivises BEPS behaviour. MNEs commonly encourage their CEOs and management teams with equity-based compensation (e.g. stock options, stock awards, etc.) that gives management a short-term fixation on share price. While this short-term fixation is economically bad for many reasons, specifically in the tax area, it directly results in CEOs and managements being strongly incentivised to aggressively profit-shift so as to lower the group's effective tax rate and push up its share price. The IMF could review existing research in this area and consider

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[2] OECD/G20 Base Erosion and Profit Shifting Project, *Addressing the Tax Challenges of the Digital Economy, Action 1 2015 Final Report*, OECD 2015: p. 65. See also *Tax Challenges Arising from Digitalisation – Interim Report 2018*, OECD 2018.

approaches that could encourage other forms of executive compensation that do not motivate profit shifting.

2. The Current State of the International Corporate Taxation System

In the past five years there have been considerable changes to international tax rules, due mainly to the G20/OECD project on base erosion and profit shifting (BEPS). The main outputs from the project delivered in 2015 patched up some major loopholes in the current rules, but the result has been to make them more complex and difficult to apply. This is a particular problem for developing countries, which are both more dependent on corporate tax revenues than rich countries and lack the resources of skilled personnel needed to administer the complex rules.

The BEPS project outputs did not directly tackle the central issue of criteria for the allocation of income of MNEs so that they could be taxed 'where economic activities occur, and value is created', as mandated by the G20. This should entail establishing clear criteria for allocating income among source countries, where the business activities take place. However, the process was dominated by the OECD countries, many of which are home to large MNEs, and tend to defend residence-based tax rights. Hence, the BEPS Action Plan stated explicitly that it was not intended to affect the existing balance of tax rights between residence and source countries.

In particular, the BEPS Action Plan defined a narrow scope for the work on transfer pricing. It affirmed that the existing rules operate 'effectively and efficiently' in many cases and specified that work should focus on their misuse. This resulted in extensive revision and expansion of the OECD Transfer Pricing Guidelines (TPGs). However, attempting to refine the ad hoc approach on which the TPGs are based has only made them more complex, obscure, subjective and difficult to apply.[3]

The TPGs require an individual analysis of the facts and circumstances of each MNE to determine the functions performed, assets used, and risks assumed by each entity (referred to as 'functional analysis'). To apply functional analysis, tax authorities need staff with a range of skills, who not only are familiar with the legal and economic techniques needed to interpret and apply the TPGs, but also understand the taxpayer's business model and industry segment well enough to analyse the documented transfer pricing model, choice of method and selection of comparables. The approach creates a burden for taxpayers, who must ensure that their transfer pricing policies are properly justified and documented. However, large MNEs can assemble a team of transfer pricing specialists to design structures aimed at tax minimisation, and to produce the necessary documentation. This has created a boom for

[3] The report on BEPS Actions 8-10 included revisions to chapters I, II, VI, VII and VIII of the TPGs, which were incorporated into the version issued in 2017, which is now over 600 pages. The most authoritative account yet published of these changes is *Transfer Pricing and the Arm's Length Principle after BEPS* (2017), by Joe Andrus (the former OECD official responsible for transfer pricing during most of the BEPS project) and Richard Collier (an experienced private practitioner). Their analysis shows how, due to disagreements among participants in the BEPS project, the TPGs have become even more uncertain and obscure. They conclude that the result has been to make the transfer pricing process 'far more complex', mostly due to the 'level of factual detail' now required for the functional analysis (paras. 7.70-71). They trace in detail how, due to these disagreements, the TPGs have been made more complex and unclear on the key points. These are (i) the notion of control of risk ('very complex', para. 6.35; 'most confusing' para. 7.32; imposing 'only limited burdens on MNEs desiring to transfer risk to tax advantaged locations', para. 7.13; and leaving 'clear potential for heated disagreement', para. 7.16); (ii) the returns which can be attributed to a cash-box entity ('quite mysterious', para. 6.46; 'most confusing' para. 7.32; will 'give rise to substantial amounts of controversy', para. 7.31; and leaving 'a rather confused muddle, at least for now', para. 7.42); and (iii) how to allocate the difference between projected and actual returns from an intangible ('far from clear', para. 7.56; 'manifestly inadequate', para. 7.58).

professional advice, so that transfer pricing has become a principal area of international tax practice, growing ever larger as more countries adopted transfer pricing regulations.

Matching the resources available to MNEs is impossible for tax authorities even from developed countries, which are often under-resourced.[4] The need to conduct a functional analysis creates a severe information asymmetry, since a company will always know more about its own business and its sector than any outsider, especially tax authorities who have little background in the industry of the MNE and no detailed knowledge of the taxpayer's operations.

Developing countries face an even greater challenge. Most of them have legislation allowing their tax authorities to adjust the accounts of affiliates of MNEs to prevent profit-shifting, while a smaller number have in recent years introduced more detailed regulations, usually based on the TPGs.[5] Some leading countries have, with support for capacity-building, begun to build up their international tax departments. Notably, Kenya created a special unit to audit MNEs after 2011 with a dozen staff in two teams; this has had some success in increasing tax revenues, although short of targets and resulting in some conflicts.[6] The unit has now expanded to 36 staff, but its head was recruited to lead Tax Inspectors Without Borders, a joint OECD-UNDP initiative. More typical is Madagascar, which enacted transfer pricing regulations in 2014 based on the TPGs, but it has had difficulty in developing an enforcement strategy and has made several requests for external assistance to do so.[7]

Despite the effort and resources needed, these methods also produce unsatisfactory outcomes. The identification of suitable comparables, even when done meticulously, only provides estimates, usually within ranges of results deemed acceptable. As the TPGs themselves point out, this is 'not an exact science', and the aim is to 'find a reasonable estimate' (TPGs 2017: para. 1.13). It is also inherently subjective, creating uncertainty and conflicts. This has been the experience of OECD countries, which have seen a continuing increase in tax disputes, as well as in the length of time taken to resolve them, the majority concerning the transfer pricing rules (see Figure 1).

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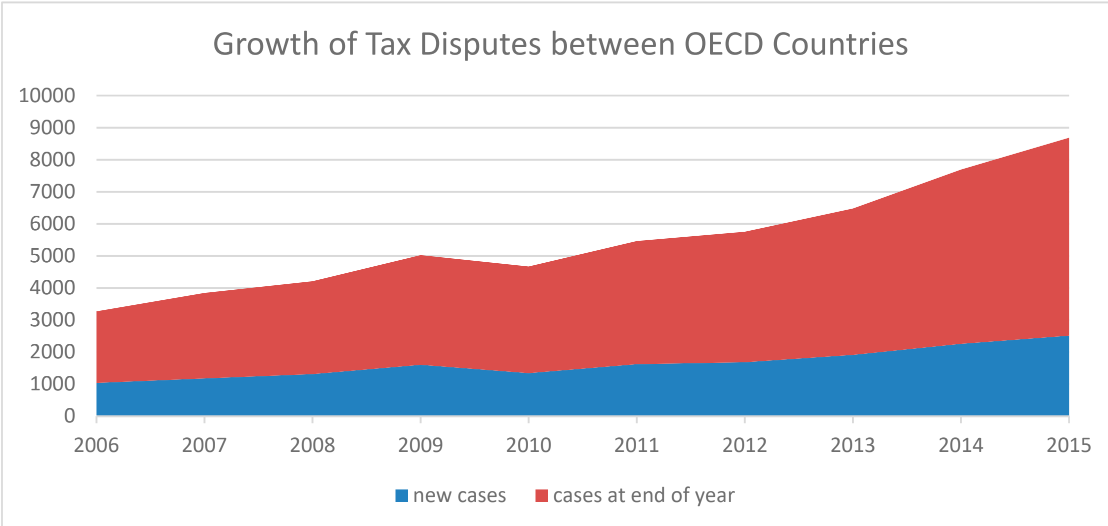
[4] In 2014 the US IRS hired a specialist consultant at a cost of $2m to assist its audit team in the examination of the transfer pricing arrangements of Microsoft (A. Gupta, 'Why has the IRS Outsourced Microsoft's Transfer Pricing Audit?', *Tax Notes International* 76: 847-51). In the UK, HMRC expanded its transfer pricing specialists from 65 to 81 between 2012 and 2016; its 6-year investigation of Google involved between 10 and 30 specialists at any one time, eventually resulting in a settlement agreeing payment of an additional £130m covering a 10-year period (UK Parliament, *Public Accounts Committee, Corporate Tax Settlements*, HC 788, 2016: paras. 4-6).

[5] For example, all but 8 of the 54 African countries have a general power to adjust accounts, while 17 have introduced detailed regulations, mostly within the past 5 years: S. Picciotto, *Problems of Transfer Pricing and Possibilities for its Simplification*, Working Paper 86, International Centre for Tax and Development, 2018, Appendix.

[6] Platform for Collaboration on Tax, *Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries*, 2016: 31; A. Waris, *How Kenya has Implemented and Adjusted to Changes in International Transfer Pricing Regulations, 1920-2016*, Working Paper 69, International Centre of Tax and Development, 2017.

[7] An IMF exploratory mission in 2015 recommended the establishment of a specialist transfer pricing unit, while also reporting that the Large Business unit had 21 inspectors, covering 576 firms, of which 93 were known affiliates of MNEs. It found that the available data indicated that MNE affiliates were generally as or more profitable in relation to domestic firms, and hence paid a relatively higher level of tax; although this probably also reflected under-declaration by domestic firms. By 2017, the Large Business unit had some 627 dossiers, and the entire staff of the revenue authority was 93, of whom 31 inspectors, six specialising in international tax, although none with in-depth skills in transfer pricing (personal communication). It still had not decided on a transfer pricing enforcement strategy.

Figure 1



Source: OECD MAP statistics, available at http://www.oecd.org/tax/dispute/map-statistics-2006-2015.htm Data collected for years from 2016 separate transfer pricing from other disputes, showing that of the 8002 cases open at the start of 2016, 56% concerned transfer pricing, and these disputes take on average around twice as long to resolve; see http://www.oecd.org/tax/dispute/mutual-agreement-procedure-statistics.htm

Hence, there is an urgent need to develop clear and simple criteria for allocation of the income of MNEs. These could greatly reduce compliance costs for taxpayers and tax authorities and provide greater certainty for investors. Such a policy reform would be far more cost-effective than providing increased aid to build the capacity in poor countries to attempt to administer the current rules.

Indeed, tax certainty has been identified as a priority by the G20 world leaders in 2016. Its importance both for taxpayers and tax authorities, including in developing countries, has been confirmed in reports by the OECD and the IMF.[8] Yet so far nothing has been done to attempt to make the tax rules themselves clearer and easier to apply. The efforts have focused particularly on improving international tax dispute settlement. This itself is an admission that the reforms made so far will actually lead to an increase in conflicts due to lack of clarity.

3. Towards Simpler and More Effective Rules for Allocation of the Income of MNEs

Simpler and more effective rules should be based on the economic reality that MNEs operate as unitary firms, instead of the inappropriate fiction of the arm's length principle. Three main systems are available that are based on this principle: (i) worldwide residence-based taxation; (ii) a destination-based cash-flow tax, and (iii) unitary taxation with formulary apportionment. The advantages and disadvantages of these have been evaluated by the Independent Commission for the Reform of International Corporate Taxation (ICRICT). The Commission's report, concludes in favour of formulary apportionment, as the other two alternatives are unlikely to favour developing countries, which are not home to multinationals (and therefore would not benefit from a move to worldwide residence-based taxation) and often are net exporting states (which would lose out under a move to a destination-based cash-flow tax.

[8] The most recent is the *Update on Tax Certainty*, Report for the G20 Finance Ministers and Central Bank Governors, July 2018.

The advantages of formulary apportionment have indeed been widely recognised, including by many business representatives. The main obstacle to adoption of such a system on an international scale is the difficulty of reaching international consensus on the methodology, especially the apportionment factors. However, it is possible to adopt an evolutionary approach and move towards an apportionment system pragmatically. This could be done by building on the profit split method (PSM), which is one of the five methods accepted in the TPGs.

The PSM has the significant merit of starting from the aggregate or consolidated profits produced by the combined activities of associated enterprises, in contrast to the one-sided methods which consider each affiliate in isolation. This is recognised in the TPGs which point out the advantages of the PSM as including that all relevant entities can be 'specifically identified and their relative values measured in order to determine an arm's length compensation'.[9] Although it has not been possible through the BEPS process to reach an international consensus on an agreed methodology, this does not preclude individual states, or preferably groups of states, from adopting more concrete methodologies that would allow objective application and an elimination of much of the subjectivity and ad hoc analyses that the TPGs now require. The TPGs have the status of international soft law, providing guidance to the interpretation of the provisions of tax treaties. This leaves considerable scope to modify the methods they recommend, especially if it can be done by groups of states acting in concert.

Such an initiative has already been taken by the European Commission, in the context of proposals for reforming tax rules to the digitalised economy for adoption by the EU. Its draft Directive issued in March 2018 proposes both a new definition of taxable presence and a methodology for attributing profits based on 'economically significant activities'.[10] It would mandate taxpayers to use the profit split method unless they can prove 'that an alternative method based on internationally accepted principles is more appropriate having regard to the results of the functional analysis' (article 5.6). It specifies the activities that should be regarded as economically significant for digitalised business models. Further work is being done on this in the EU's Joint Transfer Pricing Forum, which includes both governmental and nongovernmental members.

The draft Directive is of course only a proposal. However, it demonstrates that this approach is gaining influential support. It is clearly desirable that there should be serious examination of this approach in all relevant international forums. This should include intensive study by the IMF. The merits of the approach are not limited to digital business models. As explained in section 1, digitalisation has only exacerbated the problems with the arm's length principle. Indeed, these problems are far more acute for the poorest countries. It is difficult for such countries to act alone in pioneering a new approach. This may be easier through regional groupings. However, it is incumbent on key intergovernmental organisations such as the IMF to put significant resources into helping to formulate appropriate options especially for developing countries. It should also study in more detail the various elements of a formulary apportionment system, towards which these pragmatic reforms should aim.

[9] *Revised Guidance on the Application of the Transactional Profit Split Method*, Inclusive Framework on BEPS: Action 10, OECD June 2018, para. 2.122. This revised text has not yet been incorporated into the version of the TPGs issued in 2017 which consolidated the other revisions agreed in the BEPS reports published in 2015.

[10] *Proposal for a Council Directive laying down rules relating to the corporate taxation of a significant digital presence,* COM(2018) 147 final.

4. Building on the Profit Split Method

A significant expansion of the use of the PSM could be achieved by making it truly easy for both taxpayers and tax authorities to apply, through the elimination of much of the subjectivity inherent in the TPGs. This can be accomplished by developing standardised concrete allocation keys and weightings for common business models. Rather than focusing on subjective issues of relative risk and the relative values of varying economic functions, solely objective and location-specific factors should be used as the standardised concrete allocation keys to apportion profits. This approach would ignore internal group-controlled and tax-motivated arrangements such as intercompany contractual terms. It would also dispense with the need for subjective value judgments, greatly reducing the potential for conflict and uncertainty.[11]

It must be accepted that the application of any transfer pricing method, including even the comparable uncontrolled price method, can only produce an estimate. Under the present approach, any transfer pricing method will involve significant subjective judgments that will materially affect the outcome. These subjectively determined outcomes will usually be a range of possible prices. This is due to both the subjective judgement inherent in the individual and factual nature of functional analysis, and the difficulty of identifying appropriate comparable transactions between independent entities. This process generally produces ranges of estimated outcomes so that, in the words of the TPGs, it is 'not an exact science' (para. 1.13).

Although it has come to be used more frequently, the PSM has remained a fall-back method, often viewed with some suspicion by both taxpayers and tax authorities. This is because the way it has been applied until now increases rather than decreases the complexity of transfer pricing audits. Since its introduction in the 1995 TPGs no work has been done by the OECD to attempt to develop and standardise this method. Hence, at present it has severe limitations.

Firstly, it is frequently used only through the 'residual analysis' approach, which is a two-step process. This requires an initial functional analysis and application of one of the other methods to determine remuneration for activities considered not to involve 'unique and valuable contributions', before the PSM is applied to the 'residual' profits. In our view, the 2-step process introduces unnecessary complexity and uncertainty. The concepts of 'unique and valuable contributions' are highly subjective and applying them in practice produces conflicts. The 2-step approach can also result in inappropriate allocations of the benefits of synergy for a MNE. The aim should be to develop effective methodologies for the PSM which can properly evaluate the contributions by all relevant parties in a single step. Introducing a 2-step process negates the merits of greater ease of administration, predictability and certainty, which should be the overriding aims.

Secondly, the OECD TPGs have until now provided only generalised guidance on the selection of allocation keys. They state that the criteria used for division of the profit 'depend on the facts and circumstances of the case' and that it is therefore 'not desirable to establish a prescriptive list of criteria or profit splitting factors' (Revised PSM Guidance 2018 para. 2.166). This adds further to the ad hoc and discretionary character of transfer pricing, which makes it hard to administer, lacking in legitimacy, and a source of conflict and confusion. The lack of standardised allocation keys also leaves scope for each taxpayer to select those which most suit BEPS structures and objectives.

[11] See J. Kadet (2015), 'Expansion of the Profit Shift Method: The Wave of the Future', *Tax Notes International*, 77: 1183, and J. Kadet, T. Faccio, and S. Picciotto (2018), 'Profit Split Method: Time for Countries to Apply Standardized Approach', *Tax Notes International*, 91: 359.

We propose adoption of a combination of principles and pragmatism to systematise and standardise the PSM. The goal of simplification and clarification entails moving towards a standardisation of concrete splitting factors and weightings. However, the identification of appropriate factors, how they are quantified, and their weighting should be done bottom-up by analysing common business models. There are also some industry sectors or sub-sectors with common business models. Industry and sectoral associations could be consulted in an open and multilateral process.

These standardised allocation keys and weightings by business model/industry sector would best be agreed and set within a multilateral environment that includes countries, reputable industry and sectoral associations, and bodies such as the IMF. We believe that the IMF either alone or in conjunction with other bodies (e.g., the OECD, the World Bank, and the UN) could take a leadership position in organising and guiding the multi-party discussions and analyses that will result in these standardised keys and weightings by business model/industry sector.

While we believe strongly that a multilateral process is best, if no country or body takes a lead in creating a broad multilateral process, we encourage individual countries or groups of countries to develop their own standardised keys and weightings for the specific business models/industry sectors that are of particular importance to them. Again, such countries could involve industry and sectoral associations as part of the process.

Once standardised concrete allocation keys and weightings are agreed, they should of course be made public, a step that would increase transparency, eliminate the risk of sweetheart tax deals, and encourage other countries and regional groups to adopt the same or similar keys and weightings for common business models relevant to them. Such an approach could also be applied on a sectoral basis under Advance Pricing Arrangements.

A particularly important part of the simplification and fairness to both taxpayers and tax authorities alike is that where this PSM approach is adopted for a common business model and/or in a particular sector, all MNEs using that model or in that sector would be *required* to use the specified keys and weightings. We believe that opting-out could be permitted for an MNE, but *only if* the MNE can establish to the satisfaction of the relevant tax authority that other allocation keys and weightings, or alternatively another transfer pricing method, truly provides a demonstrably more arm's length result. The burden of proof would thus be on the MNE if it wishes to opt out and use another method, or any keys and weightings other than those set out in the specified business model/sectoral arrangement.

This is true simplification for tax authorities and MNEs alike. Under this approach, it would only be necessary for tax authorities to get involved in understanding and analysing the accurately delineated controlled transactions when a taxpayer group makes a claim that another transfer pricing method or other keys and weightings should be used. Taxpayers would gain the predictability of being able to rely on the prescribed methodology and standardised allocation keys and weightings. This would dispense with the need for taxpayers to employ a small army of specialists to devise transactional transfer pricing methodologies, and produce the detailed documentation (including very expensive functional analyses for each product or service line) needed to defend them in case of audit.

From the perspective of principles, the main factors that can be considered to generate profit are: (i) employees, (ii) capital assets and (iii) sales revenues. The first two represent the factors that create value: labour and capital. The third is essential for realisation of profits. It is no coincidence that these are the factors that have been used in formulary apportionment systems on a sub-national level, notably in the USA, and for the EU's proposed Common Consolidated Corporate Tax Base (CCCTB).

These factors have three merits: (i) they reflect at a generic level the factors which generate profits; (ii) they can be quantified, and (iii) they are location-specific, so can be used to allocate profits according to where real activities take place. They would not eliminate tax competition, but it would be more benign competition, to attract real activities. Using a balance of production factors and sales (to reflect consumption) would minimise the impact of tax on the choice of location for productive activities.

It should be pointed out that these factors are already used in a pragmatic way when the PSM is applied to an individual MNE. The OECD Guidance on the Profit Split Method (revised in 2018) stresses that the allocation factors should be based on objective data (e.g. sales to independent parties) and should be verifiable (para. 2.166). It suggests the use of operating assets or fixed assets (para. 2.171). It also specifies employee compensation, while adding that in some circumstances headcount or time spent could be appropriate (para. 2.172). Similarly, in determining the assumption or control of risk, the authorised OECD approach to the attribution of profits to a permanent establishment uses the concept of 'significant people functions', which is usually quantified by using payroll costs. However, the pragmatic approach should be used to move away from ad hoc and individualised application of the PSM, by adopting standardised factors and weightings.

Conversely, systems for formulary apportionment also provide for industry-specific variations for distinctive sectors, notably extractive industries and financial services. These broad sectors also include sub-sectors, or different business models. For example, some extractive industry MNEs are vertically-integrated, while others specialise only in exploration and/or extraction. The financial sector also includes a wide variety of sub-sectors. Hence, it would be more appropriate to identify appropriate splitting factors by analysing these sub-sectors.

A bottom-up approach could also be very helpful in clarifying both how the factors should be quantified and their weightings, which could vary according to the industry and business model. For example, in relation to the people factor, there may be issues in relation to the definition of employees in business models which extensively use self-employed contractors. Similarly, a bottom-up approach will help determine how to attribute employee contributions to a specific location, where employees are mobile. Also, it may be appropriate to adjust the quantification of payroll costs by using purchasing power parity, or to use either one or a combination of payroll and headcount.

The definition and quantification of assets also require clarification, as accounting standards are notoriously uncertain in this respect, even for physical assets. The need to ensure that factors are location-specific means that transferable intangible assets such as intellectual property rights are not appropriate to be used as splitting factors. The TPGs have now moved away from mere ownership of intangibles as a basis for allocating profits, and now point to the contributions made by entities in the 'development, enhancement, maintenance, protection and exploitation' of intangibles (DEMPE functions: TPGs 2017: ch. VI, section B). An appropriate way of quantifying these contributions is likely to be the payroll costs of entities fulfilling these activities. Although some intangible assets can be location-specific (for example, marketing assets such as customer lists), they cannot be objectively measured, so should not be included as possible allocation keys. Rather, they are indirectly reflected through the sales factor. Also, in the context of digitalisation of the economy and business models that include as assets their contributing user base and/or user-provided data, there can be objective measures of the number of users and the quantum of data. These types of factors, where appropriate, should be included as objective allocation keys that reflect real assets.

We believe that a significant number of highly integrated MNEs operate through a limited number of sufficiently similar business models such that determining standardised allocation keys and weightings that would be applicable to these MNEs would result in fair results with significantly less expended resources for both taxpayers and governments.

Base erosion and profit shifting techniques are aimed at minimising taxable profits in the country of source, so that the balance of profits is allocated to the home country of multinationals or in conduit jurisdictions, where profits are taxed at low or zero rates. A wider and standardised application of profit split will rebalance this allocation of profits to ensure that MNE income and tax are attributed where they have real activities and create value. This will almost invariably benefit both developed and developing countries. The lack of correlation between reported income and activities creating value was what so motivated governments to initiate the G20/OECD BEPS project in the first place. In our view it is time to move away from the fictitious and ineffective arm's length principle, and to develop a methodology for allocation of MNE profits which would be fairer, easier to apply, and provide much predictability and certainty for all concerned.

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10 December 2018

Response from the Centre for Budget and Governance Accountability (CBGA) to the Consultation on an IMF 2019 Analysis of International Corporate Taxation

To whom it may concern,

Greetings from CBGA[1], New Delhi! We welcome the opportunity to respond to the IMF's request for input in drafting the new analysis on the international corporate taxation system and its possible future directions.

The Base Erosion and Profit Shifting (BEPS) international reform led by the G20 and the OECD clearly has made progress that would have been thought of as difficult just five years ago. That this pace of change has been possible is a strong indicator of the rise in public interest, and concern, in these matters and highlights the need to be even more ambitious.

While this reform has proposed some solutions for some of the most egregious tax avoidance mechanisms, it has failed to deal with the core mechanism of tax avoidance. The transfer pricing system and other tax avoidance mechanisms remain available to multinationals and are in fact incentivised and legitimised as a result of the BEPS process.

We believe that one of the biggest deficiencies of the BEPS process has been its inability to address the core problem of our global tax system[2]: the separate entity approach to taxation and transfer pricing. Nowhere is this more evident as in its inability to come to terms with the changes brought about by the digital economy, which is increasingly becoming the economy itself.

The reform of the international corporate tax system is at a critical juncture. The OECD has achieved what it could, within the constraints of its mandate, but has shied away from examination of the most fundamental problem. The OECD ongoing work on the digital economy exposes all the contradictions of transfer pricing to the extreme and demonstrates that it is no longer fit for purpose.

The international community is at a crossroads: continue to tinker at the edges with a broken system designed for the last century or look at solutions designed to fix the problems of this century and deliver a sustainable international tax architecture fit for purpose. The risk is that if we do not fix the current system then disenchantment with the

[1] CBGA is an independent policy research organisation that works on government finances, public policy issues and transparency in the global financial system.
[2] See the Kathmandu Declaration on Curbing Illicit Financial Flows: Restoring Justice for Human Rights

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global tax system will feed into the ever-growing distrust of global institutions and the rise of populist politics.

The current multinationals' tax avoidance structures are conceptually straight-forward: low profits are declared in high-tax jurisdictions, both in developed and developing countries, through the use of limited risk structures (e.g. limited risk distributors/manufacturers), excessive debt and deductions for intangibles, so that the balance of profits is attributed to intellectual property, funding and strategic functions/risks (e.g. global procurement, management, intellectual property related activities) in low tax jurisdictions. As IP and non-intensive labour functions can easily be relocated where it is most tax effective with the current system, multinationals can in practice decide how they distribute their profits across jurisdictions. A system that attributes the large share of its profits to the ownership of intellectual property and the performance of certain functions/risks is also particularly detrimental to developing countries, which are not home to multinationals' headquarters and intellectual property.

The arm's length principle or the separate accounting principle to calculate transfer price is essentially flawed and we recommend moving away from this as a practice. **There is a need to discuss alternative measures like the formula apportionment method but these measures should not be decided upon without proper consultation with developing countries.**

Please refer to the report on A Fairer Future for Global Taxation for further reading.

A system of **multi-factor global formulary apportionment**, **together with a global effective minimum corporate tax rate**, is an alternative method of ensuring that source countries where the activities generating MNE's profits take place receive their fair share of tax revenues from these profits. A global effective minimum tax drastically reduces the financial incentives for multinationals to shift profits between jurisdictions and for countries to cut their tax rates.

The allocation of multinationals' profits between countries for taxation purposes is a fundamentally distributive task. Multinationals are unitary businesses making profits in a global marketplace, where profit can only be achieved through the integration of their activities across jurisdictions, and the value of the multinational as a whole is bigger than the sum of its individual parts.

A simple, formulaic approach would ensure that global profits and associated taxes could then be allocated according to objective factors such as the sales, employment, resources (and even digital users) used by the company in each country, rather than where they locate their different functions (procurement, marketing, funding, etc) and claim their Intellectual Property.

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The use of the profit split method to allocate profits can be useful if the allocation factors used to split the profit are standardised and weighted consistently; else in our view it would create further opportunities for tax avoidance.

During the next phase of the BEPS process (“BEPS 2.0”) we urge governments represented in the Inclusive Framework, the UN Tax Committee and all multilateral institutions, to move away from the current transfer pricing system and look for alternative solutions to discourage abusive transfer pricing practices. Furthermore, most developing countries do not have the policy space to shape international tax standards which affect them disproportionately. It is imperative that developing countries are heavily consulted with before the next phase of BEPS.

We value the important role that the IMF can play in the step towards sustainable international tax architecture. We can assure you of our support in all your efforts towards this aim we remain at your disposal should you wish to discuss this important issue further.

Yours sincerely,

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Consultation on an IMF 2019 Analysis of International Corporate Taxation

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Contribution from the European Network on Debt and Development (Eurodad)

In response to the IMF consultation on an IMF 2019 Analysis of International Corporate Taxation, please find below the contribution from Eurodad.

Current state of the international corporate taxation system

The outcome of the OECD and G20 negotiation on BEPS

Review vs. reform

Base Erosion and Profit Shifting (BEPS) was launched in connection with a G20 decision, which stated the objective of ensuring the profits of multinational corporations were taxed "where economic activities occur and value is created".[1] This objective was later confirmed by the United Nations' (UN) Summit on Financing for Development in 2015.[2]

However, the final BEPS package, which was negotiated under the Organisation for Economic Co-operation and Development (OECD) and G20, constituted a review of the international corporate tax system that was not the fundamental reform the system needs to fulfil the G20's objective.

First of all, BEPS failed to consider alternatives to the 'arm's length principle', including the pros and cons of moving towards unitary taxation with formulary apportionment. Instead, BEPS was developed as a continuation of a transfer pricing system that has proven to be unsuitable as the basis for taxing multinational corporations.

Secondly, the BEPS action plan specifically avoided addressing the division of taxing rights between source and residence countries, and instead underlined that the actions in the plan were "not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income."[3] The question of division of taxing rights is one of the most central questions for developing countries, which fall into the category of source countries in the vast majority of cases, and as a result of that are systematically disadvantaged by the OECD's approach to allocating taxing rights.

The fact that BEPS avoided two of the most central issues of international taxation, and instead was developed as the continuation of a system that has long been outdated, also limited the usefulness and relevance of the outcome. The consequence is that BEPS has become a 'sticking plaster' for a broken system, rather than a real long-term viable alternative.

The risk of BEPS compliant tax avoidance

The Paradise Papers that were published in 2017 revealed examples of how corporations were allegedly changing their tax arrangements to accommodate international criticism and adjust to changing tax practices, while seemingly continuing to avoid large amounts of taxes.[4] This underlined the problem of partial solutions to the international tax system, where some loopholes are closed while others are kept open, since it illustrated the adaptive nature of international corporate tax avoidance. It also highlighted the problem of slow transition processes, where harmful tax practices are phased out over a longer period of years, thus allowing corporations to set up new tax avoidance structures to replace old ones.

BEPS was, at best, only a partial solution. While some loopholes were closed (for example, some of the loopholes relating to the permanent establishment standards), and others were limited (for example, the interest deductability standards), BEPS also endorsed and kept open certain major loopholes. This includes the use of patent boxes. Despite the BEPS decision to introduce the so-called "modified nexus" approach, many patent boxes are still harmful tax practices that can be abused for tax avoidance purposes, and furthermore do little to promote research and development. After the adoption of BEPS, the number of countries using patent boxes increased significantly in Europe.[5] However, the fact that patent boxes, which include the modified nexus rules, are now officially BEPS compliant has caused the OECD's 'peer review process' to declare the vast majority of the European patent boxes officially "not harmful".[6]

This was not the conclusion of the International Monetary Fund (IMF), which in its biannual 2016 *Fiscal Monitor* highlighted that "patent boxes (which reduce taxes on income from intellectual property) are often not cost-effective in stimulating [research and development]. In some cases, they are simply part of an aggressive tax competition strategy".[7]

Similar concerns have been echoed by the European Commission, which highlights that "patent boxes give a tax break on the output from [research and development] activities i.e. earned from exploiting intellectual property rights. Research shows that they do not stimulate [research and development] and may rather be used as a profit-shifting instrument, leading to high revenue losses."[8]

In addition to the proliferation of patent boxes, several EU Member States have introduced systematic tax credits, allowances and reductions of taxes on intellectual property (IP), in compliance with BEPS substance requirements. Through the provision of amortisation relief on IP acquirement, high or complete capital allowances for intellectual property and the introduction or extension of research and development credits,[9] EU Member States have facilitated on-shoring of IP from low tax countries outside the EU to EU Member States. While the new schemes may satisfy the BEPS substance requirements, evidence suggests they may continue to facilitate tax avoidance.[10]

Thus, rather than meaningfully realigning economic activity and value-creation with taxation, there is a clear risk that BEPS has stimulated the development of new BEPS complaint schemes, which may fulfil basic substance requirements, but may at the same time facilitate large-scale corporate tax avoidance.

BEPS also included anti-avoidance mechanisms, and most prominently the principal purpose test (PPT), which allows a country to deny treaty benefits when it can be shown that one of the principal purposes of a transaction is to avoid taxes.[11] Unfortunately, the PPT can be difficult to use. The OECD underlines that, "It should not be lightly assumed, however, that obtaining a benefit under a tax treaty was one of the principal purposes of an arrangement or transaction, and merely reviewing the effects of an arrangement will not usually enable a conclusion to be drawn about its purposes. Where, however, an arrangement can only be reasonably explained by a benefit that arises under a treaty, it may be concluded that one of the principal purposes of that arrangement was to obtain the benefit."[12] This is not easily proven, especially by developing countries with few resources and limited access to information. Furthermore, the PPT is not a mandatory requirement of BEPS.

Increased complexity and advance pricing agreements (APAs)

With its additional layers of guidance and vaguely defined concepts, BEPS has increased the complexity of the international tax system significantly. This, and the fact that the ‘arm’s length principle’ is anything but an exact science, has made it increasingly unclear how the profits of multinational corporations will be distributed between different countries where the corporations operate, and thus, how much tax the corporations will pay. To accommodate for this, countries negotiate and sign secret advance pricing agreements (APAs) with individual corporations, to define how the transfer pricing guidelines will be applied in the case of that particular corporation. However, this approach entails a number of problems.

Firstly, the agreements concern the future, and thus the tax administration is not able to see the tax return or country by country report of the multinational corporation before entering into the agreement, since these are submitted after the tax year has ended. If the administration later discovers that the corporation is engaged in large-scale tax avoidance, the advance agreement can limit the administration’s chances of intervening. Furthermore, the agreements are often binding for the tax administrations that enter into them, normally for a predetermined period of, for example, five years.

Additionally, it is problematic that the agreements are requested by individual corporations and issued specifically to them, often following a bilateral negotiating process. This introduces the risk of special treatment for powerful and influential corporations, as well as lack of equality before the law between different corporations.

Lastly, the agreements are secret to the public, and whistleblowers who release information about the deals risk being litigated against.

As can be seen from several cases that the European Commission has raised against Member States for alleged state aid, APAs can potentially be vehicles of large-scale corporate tax avoidance.[13]

As the mechanism for ensuring international exchange of information about APAs between tax administrations, BEPS relies on the ‘spontaneous exchange’ system.[14] However, this kind of system was introduced in the European Union as early as 1977 and was recently abolished in recognition of the fact that it had failed. Instead it was replaced by a system based on automatic exchange.[15]

The research into developing countries’ experiences with APAs is still limited, but given the important role of these agreements, and the high number of risks involved, this ought to be a priority issue.

BEPS and country by country reporting

BEPS included the introduction of country by country reporting (CbCR).[16] However, while it is positive that BEPS recognised the value of CbCR as a risk assessment tool, BEPS failed to recognise the importance of making the information public, and instead restricted access to CbC reports to exchanges of information between tax administrations.

Although tax administrators that get access to confidential CbC reports might be able to identify high risks of tax avoidance, they might have very limited possibilities for intervening. Firstly, tax avoidance by multinational corporations is often not illegal, and it can therefore be difficult to stop it through prosecution. The European Commission’s state aid cases (see above under ‘Increased complexity and advance pricing agreements) are examples of how efforts to make corporations pay tax can turn into lengthy court processes.

Secondly, pursuing corporate tax avoidance is often a very political issue, and the tax administrator might not have the necessary support from political decision makers to pursue a powerful multinational corporation.

And lastly, the information is strictly confidential. Therefore, the tax administrator is not allowed to tell the public or, for example, parliamentarians about the tax behaviour of the corporation. This confidentiality also limits the tax administrator's potential for discussing with other experts and tax administrations. Violating this confidentiality can put the tax administrator at risk of being fired, prosecuted or potentially facing heavily penalties.
Sadly, because developing country tax administrators have much less access to key information about multinational corporations, a tax administrator in a developed country can also end up looking at information that indicates that a corporation is dodging taxes in developing countries, but not be allowed to share this information with the tax administrators in the countries that are being affected.

It should also be noted that the automatic exchange of CbC reports under BEPS comes with a number of restrictions that can limit the abilities of countries to collect taxes from multinational corporations. For example, the OECD guidelines require tax administrations that send CBC reports to other tax administrations to "have measures in place to establish that information contained in CbC Reports has not been used as conclusive evidence that transfer prices are incorrect, and the adjustment is not based on global formulary apportionment of income using CbCR information."[17]

Public information about country by country reports would, on the other hand, allow tax administrators to benefit from public support for stopping corporate tax avoidance, and although the public can never replace tax administrators, scrutiny of public information by, for example, journalists and civil society, can help identify cases where multinational corporations are engaged in questionable tax practices. Public information will also allow tax administrators to openly share thoughts, insights and experiences with other tax administrators around the world – something that can be particularly important for developing country tax administrators.

Public CBCR was introduced for banks in the EU before the BEPS package was finalised, and research indicates that it can act as a disincentive for corporate tax avoidance.[18] Since 2016, the EU has also considered introducing public CBCR for all sectors. Unfortunately, the OECD has used the BEPS outcome to argue actively against public CBCR,[19] and there is a clear risk that BEPS has undermined the political will of governments to pursue greater transparency around corporate taxation.

The Multilateral Convention to implement the treaty related parts of BEPS

With an approach resting on thousands of bilateral tax treaties, international taxation is already a very complex area. Unfortunately, while the BEPS Multilateral Instrument (MLI) was originally aimed at ensuring "co-ordination and consistency"[20] in BEPS implementation, the agreement has ended up as a highly complex multiple choice agreement, which allows signatories to opt in and out of a multitude of different types of commitments. The obvious alternative would have been for the BEPS convention to outline a set of clear commitments and implementation methods, and then require all signatories to commit to following this. Adding further to the complexity is the fact that each country can decide that their commitments under the BEPS convention should only apply to some of their treaties, but not all. Therefore, the MLI is yet another point where the BEPS process ended up further complicating international taxation.

Restrictive bilateral tax treaties

Another issue that remains unaddressed is the concern about how bilateral tax treaties restrict and undermine the abilities of developing countries to tax multinational corporations. Despite the fact that this concern has been raised for years, the worrying trend seems to be continuing. For example, a recent study by Martin Hearson highlights the restrictive nature of tax treaties between EU countries and developing countries.[21]

The future of corporate tax

As long as the transfer pricing system is kept in place, corporations will be able to shift their profits and avoid taxes, and the objective of taxing multinational corporations where economic activities occur and value is created will remain unfulfilled. Digitalisation of the economy is exacerbating the problem of large-scale corporate tax avoidance in all industries and sectors, and further undermines the link between real economic activities and taxation.

BEPS has changed the international tax standards in favour of more complex, high-capacity tax havens, to the disadvantage of more simple (typically zero-tax) jurisdictions. The substance requirements can mean that tax havens will now demand higher payments for their services (in the form, for example, of a minimum number of employees or office expenses in their country). However, it will not change the fact that corporations will be paying very low rates of taxation, and that the countries where the real economic activity takes place will lose tax income because the profits have been shifted to low-tax jurisdictions. By keeping country by country reporting secret, the BEPS package aimed to prevent public transparency around the true tax payments and economic activities of corporations. However, this is not likely to succeed. With the increasing digitalisation of the economy, it has become substantially easier for whistleblowers to leak information, and the truth about corporate tax avoidance is likely to be revealed sooner or later. Thus, international tax scandals are likely to continue, and public anger is likely to continue growing. This will, in turn, create a more unstable political climate, which could cause more governments to react with unilateral actions to increase the tax payments of multinational corporations.

Meanwhile, the continued existence of corporate tax havens will also create pressure on governments to continue the race to the bottom on corporate taxation. The average global corporate tax rate has been dropping rapidly over the last decades, from above 40 per cent in the early 1980s to the current level, which is below 25 per cent (see also Figure 1).[22] Based on IMF data, Eurodad has calculated that, if current developments continue, the global average corporate tax rate will hit zero in 2052.[23]

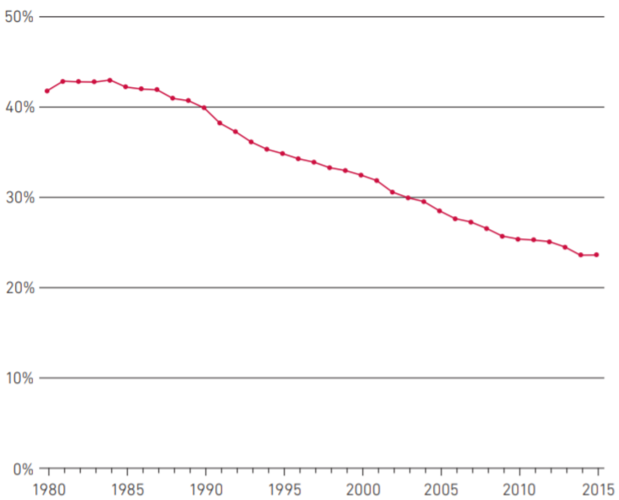

Figure 1: Global average corporate tax rate, 1980 to 2015[24]

In short, if intergovernmental tax cooperation continues to fail, the area of corporate tax system will most likely continue to be very politically unstable, corporate tax payments will remain very low, and public scandals will remain frequent.

Alternatively, the current chaotic situation could cause a "coalition of progressive countries" to emerge, which lead the development of a new global tax system (see below under 'International tax cooperation' and 'The need for a UN convention to tax cooperation and related transparency').

Taxation and human rights

Recently, concerns have also been raised about ways in which new types of taxation could jeopardise basic human rights such as freedom of speech and information. This is not least the case with new types of social media taxes.[25] Whether this trend will continue is difficult to predict, but it is an issue that deserves careful attention.
Eurodad encourages the IMF to consider the aspect of human rights impact assessments when assessing the international corporate tax system, noting both direct impacts on human rights, as well as the legal obligations arising from international human rights law to maximise available resources for financing rights and ensuring that extra-territorial impacts of domestic tax policy do not undermine obligations of international cooperation.[26]

The role of unitary/formulary methods

Formulary apportionment

Eurodad believes that a unitary approach with formulary apportionment could be an important step towards ensuring that multinational corporations pay taxes where economic activities occur and where value is created. However, such a system should be complemented with a minimum effective corporate tax rate, and should avoid introducing new mechanisms that can be abused by multinational corporations to dodge taxes, including large-scale tax deductions.

In order to ensure standardised and objective allocation of taxing rights between countries, the formula should be based on objective and location-specific factors. Furthermore, the formula should be developed in a forum where all countries negotiate as equals, and careful consideration should be given towards the interests of source countries, and in particular the poorest countries. This includes ensuring a strong mechanism for taxing extractive industries, which can ensure proper valuation of natural resources, and allocation of a significant part of the taxing rights to the country of extraction. It also includes strong emphasis on criteria that tend to benefit poorer countries, such as number of employees (by headcount).

Profit Split Method

The Profit Split Method is an acknowledged method under the OECD Transfer Pricing Guidelines, and has the advantage that it can be applied to the consolidated profits of subsidiaries of multinational corporations, as opposed to a method that considers each subsidiary independently from the others. It could therefore serve as a stepwise approach to unitary taxation. However, in order for the Profit Split Method to become more standardised, systematic, objective and easier to use, more detailed guidance would have to be developed. First, instead of the two-step method currently outlined in the residual profit split method, the approach should be carried out in one step, where the contributions of all relevant subsidiaries can be evaluated. Second, concrete allocation methods should be developed for typical business models. Such allocation methods should – similarly to full-scale formulary apportionment – be based on objective and location-specific factors. They should also take fully into account the interests of source countries, and in particular the poorest countries. The allocation methods should disregard intra-group arrangements and subjective factors such as relative values and risks associated with specific economic functions within the group.

The role of destination-based taxation

In a unitary tax system with formulary apportionment, ‘sales’ would be one of the factors in the formula for dividing taxing rights between countries. However, considering the overall objective of ensuring that multinational corporations are taxed where economic activities occur and value is created, it would be wrong to argue that sales are the only relevant economic activity. Such a system would also, for example, be deeply unfair towards countries where large-scale production or natural resource extraction take place. At the global scale, poorer developing countries play a more significant role as countries of production or extraction than as countries of final sale. Therefore, destination-based taxation would be unfavourable to these countries, as opposed to a system that takes a more holistic approach to the concept of economic activity.

In the discussion about taxation of the digital economy, some of the countries that have large consumer markets but few digital corporations domiciled within their own jurisdictions, have started arguing in favour of destination-based taxation for digital corporations, and have even started introducing such taxes unilaterally. However, this development is not an expression of an emerging global consensus, but rather an expression of intergovernmental fragmentation and the failure of international tax cooperation. In the longer run, the countries that stand to lose out on destination-based taxation are unlikely to accept this as the prevailing global principle, and are more likely to respond with similar unilateral measures that match their own economic interests. Thus, the most likely outcome will be an increase in international tax disputes and double-taxation. This development is a natural consequence of the fact that the OECD tax standards are failing countries all around the world, and that corporate tax avoidance is increasingly becoming politically unacceptable. However, the emerging international chaos will also strengthen the call for international order and could, in the longer run, create growing support for truly global tax cooperation.

Limiting the tax base to excess profit

Limiting the tax base to excess profit is an expression of the global race to the bottom of corporate taxation. Such a tax system would significantly lower the revenues from corporate taxation, and in turn lead to further cuts to the public sector, or increasing taxes on other actors in society, including consumers and workers. This would, in turn, create and exacerbate high risks of growing inequalities.

The key argument in favour of nominal interest deductions, or allowance for corporate equity, is the fact that tax deductions related to debt are not matched by tax incentives for equity. However, this argument ignores the fact that intra-group loans are a key source of large-scale corporate tax avoidance, and that there are therefore strong reasons for introducing further limitations on interest deductions, rather than compensating for these loopholes by introducing additional loopholes relating to equity.

A system based on shareholder taxation would not be in line with the objective of taxing multinational corporations where economic activities occur and value is created, and would lead to a division of international taxing rights that would be deeply unfair to the poorest countries, where only very few shareholders are based.

Minimum corporate income tax

Minimum effective corporate income tax rate

Eurodad is in favour of introducing a minimum effective corporate income tax rate, as a complimentary element to a unitary system with formulary apportionment. Without formulary apportionment, the minimum effective corporate tax rate could address international tax avoidance, but would not address the question of how to ensure a fair allocation of taxing rights between countries.

US GILTI provision

In terms of the US Global Intangible Low-taxed income (GILTI) provision, Eurodad finds that the fact that all profits under 10 per cent of a corporation's overseas tangible investments are exempted from taxation will greatly undermine the effectiveness of the provision. Furthermore, the fact that the profits, which are subject to taxation, are only taxed at 10.5 per cent, i.e. half of the federal corporate income tax rate, means that corporations will still have a tax incentive to move offshore.

Taxes targeting digital activities

Eurodad finds that digital activities can form a part of the allocation formula as part of a unitary tax system. However, specific taxes that are only based on digital activities would fail to reflect the diverse nature of the concept of economic activity. As explained above, Eurodad finds it important that taxing rights are divided between countries based on a formula that takes fully into account the interests of source countries, and in particular the poorest countries.

International tax cooperation

For years, the Group of 77, which represents over 130 developing countries, has been calling for the establishment of an intergovernmental tax body under the UN to lead the setting of global tax standards.[27] This request has repeatedly been rejected by OECD countries, which have instead insisted on keeping the standard setting under the auspices of the OECD and G20.

In 2015, the OECD and G20 adopted the BEPS standards after a negotiating process from which over 100 developing countries were excluded. After the BEPS package – a document of almost 2,000 pages – was adopted, the OECD set up the implementation body known as the Inclusive Framework, where all countries were invited to come and follow the agreed standards 'on an equal footing', and participate in the negotiation of any additional BEPS decisions. However, in order to join the Inclusive Framework, developing countries were required to sign up to the decisions that had already been made,[28] and any additional decisions will most likely be expected to follow the pre-agreed BEPS package. Eurodad finds that such an approach does not allow countries to participate on a truly equal footing, and deprives developing countries that are not members of the G20 of the opportunity to participate in the global agenda setting. Furthermore, Eurodad believes that international tax cooperation took a turn for the worse when the EU in December 2017 decided to blacklist countries that had not committed to following the OECD standards as 'non-cooperative jurisdictions',[29] and threatened to apply financial sanctions against these countries.[30]

Especially keeping in mind the many shortcomings of BEPS (see above), it is highly problematic that there is no intergovernmental forum where all countries can participate in the agenda setting. As mentioned above, BEPS specifically excluded a reconsideration of the allocation of taxing rights between source and residence countries. Therefore, there is currently no international space where developing countries can demand that this issue should be negotiated.

Eurodad also finds it very problematic that the intergovernmental decision making by the OECD and G20 remains highly secretive and opaque. Neither the BEPS process, nor the Inclusive Framework, allows for civil society observers to be present during the intergovernmental deliberations. Therefore, the public accountability of governments remains very low.

While the OECD can continue to provide a forum for its members to discuss international taxation, Eurodad believes that the global standard setting should take place in an intergovernmental Commission under the auspices of the UN, where all countries can participate on a truly equal footing. Such a Commission should be open to civil society observers, and provided with sufficient resources to lead the intergovernmental negotiations towards an agreed outcome (see below under 'The need for an international convention on tax cooperation and related transparency').

Other issues

The need for an international convention on tax cooperation and related transparency

Eurodad believes that ultimately, an international convention on tax cooperation and related transparency is needed. Such a convention should be the outcome of an intergovernmental negotiation under the auspices of the UN (see above under 'International tax cooperation'), and should among other things:

- Establish the international principle that one country should not undermine the tax base of another;
- Establish a new framework for international taxation, including new principles for allocation of taxing rights between countries;
- Set up the international framework for transparency, including public country by country reporting;
- Provide solid compliance mechanisms, to ensure fairness and transparency in international taxation.

If international consensus cannot be found, the intergovernmental UN negotiations could provide the space for 'coalitions of the willing' to take shape and move forward. Although it is likely that certain countries will initially reject the international agreement, the long-term interest in ensuring that their domestic companies have access to the markets of other countries, and are not subject to double-taxation, will eventually create strong incentives for all countries to join the consensus.

The need for spill-over analyses
One important tool to identify and mitigate negative cross-border impacts of harmful tax practices is the concept of spill-over analyses. Such a tool would not least be important for ensuring that commitments to ensure policy coherence for development are fulfilled.
However, it is important that such analyses should be anchored in a systematic approach, preferably as part of a recurrent multilateral evaluation process, and include a distinctive qualitative element. Thorough and interesting proposals for systematic approaches have been developed by ActionAid[31] as well as most recently Andrew Baker and Richard Murphy.[32]

Binding arbitration

Eurodad would like to express concern about the OECD's approach to binding arbitration, and contained in the OECD Model Tax Convention. Under the OECD model, arbitration can be triggered if two tax administrations have been unable to resolve a dispute within two years, and if it is requested by the corporation concerned in the tax dispute.[33] Arbitration entails the disputed issues being sent to a group of appointed arbitrators, most commonly corporate tax experts,[34] to make a decision. If countries decide to commit to arbitration as suggested by the OECD,[35] they will be bound to follow the decision of the arbitrators.[36] This is not the case for the concerned corporation, which has the right to reject the outcome[37] and decide to pursue other avenues instead, such as initiating a national court case in one of the countries involved.

While most OECD countries are in favour of mandatory binding arbitration,[38] a number of concerns have been raised by developing countries and other commentators. This includes a concern about whether the interests of countries can be properly safeguarded by a group of private arbitrators, and whether it is in reality possible to ensure that arbitrators are neutral and truly independent.[39] Eurodad agrees with these concerns.

Furthermore, Eurodad finds it concerning that arbitration processes are carried out in absolute secrecy.[40] At most, the public will receive information about the overall number of cases, but information about the content of the dispute, the name of the corporation involved, the names of the arbitrators and, critically, the outcome of the case, will be kept secret from the public.[41] This creates the obvious concern that no international case law will be developed, which can set a precedent for how disputes are resolved, and the public lacks insight into the realities of how transfer pricing legislation is applied. But at a much more fundamental level, secret binding arbitration entails a risk that a high amount of supra-national power will be concentrated in the hands of a few corporate tax experts with no accountability to the public.

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[25] See for example Oryem Nyeko, Uganda's Troubling Social Media Tax, Human Rights Watch, 2018, https://www.hrw.org/news/2018/07/02/ugandas-troubling-social-media-tax#.

[26] International treaty law: Article 2.1 of the International Covenant on Economic, Social and Cultural Rights, Article 4 of the United Nations Convention on the Rights of the Child, Articles 11 and 32 of the Convention on the Rights of Persons with Disabilities, Article 21 of the Maastricht Principles; Supplement No. 3 (E/1991/23), annex III Maastrict Guidelines on violations of economic social and cultural rights; Committee on Economic, Social and Cultural Rights, general comment No. 3); Readings and interpretations: CEDAW/C-CHE/CO/4-5, Concluding Observations of the United Nations Committee on the Elimination of All Forms of Violence Against Women towards Switzerland on the extraterritorial impact of its tax policies on women's rights in other states; A/HRC/26/28, 2014 Report of the Special Rapporteur on extreme poverty and human rights, Magdalena Sepúlveda Carmona on Taxation and Human Rights.

[27] Statement on behalf of Group of 77 and China by Mr. Sameh Elkhishin, First Secretary of the Permanent Mission of Egypt to the United Nations, at the ECOSOC Special Meeting on International Cooperation in Tax Matters, 18 May 2018, http://www.g77.org/statement/getstatement.php?id=180518b.

[28] OECD, Background brief – Inclusive Framework on BEPS, 2017, http://www.oecd.org/tax/beps/background-brief-inclusive-framework-for-beps-implementation.pdf.

[29] Council of the European Union, The EU list of non-cooperative jurisdictions for tax purposes, Council conclusions (adopted 5 December 2017), https://www.consilium.europa.eu/media/33082/council-conclusions-non-cooperative-jurisdictions-5-december-2017.pdf.

[30] European Commission, Fair taxation: Commission puts in place first EU counter-measures on listed non-cooperative tax jurisdictions, 2018, http://europa.eu/rapid/press-release_IP-18-2245_en.htm.

[31] Martin Brehm Christensen, Stemming the Spills, ActionAid, 2018, http://www.actionaid.org/sites/files/actionaid/stemming_the_spills_online.pdf.

[32] Andrew Baker and Richard Murphy, The Political Economy of Tax Spillover: A New Multilateral Framework, Global Policy, 2019 (forthcoming).

[33] OECD, '2017 Update to the OECD Model Tax Convention', 21 November 2017, http://www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf, page 20-21.

[34] Previously, the OECD Model also provided the option that a government official from a country involved in the case could also become an arbitrator, as long as this official had not previously been involved in the case. However, this provision was deleted in the 2017 update to the OECD Model. Instead, it is now required that the arbitrators are individuals with experience or expertise in international tax matters, and furthermore independent from the governments of the countries involved. See OECD, '2017 Update to the OECD Model Tax Convention', 21 November 2017, http://www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf, page 197 and 200. Sol Picciotto, Emeritus Professor of Law at Lancaster University, highlights that arbitrators can typically be expected to come from a 'small group of like-thinking insiders', especially from the international tax corporations such as the big four (PwC, EY, Deloitte, KPMG) and Baker McKenzie. See Sol Picciotto, 'International Tax Disputes: Between Supranational Administration and Adjudication', International Centre for Tax and Development, Working Paper 55, August 2016, http://www.ictd.ac/publication/2-working-papers/142-international-tax-disputes-between-supranational-administration-and-adjudication.

[35] The UN also integrated arbitration as one option in its Model Tax Convention in 2011. Unlike the OECD model, the UN model allows for the two countries to disregard the arbitrators' decision if they themselves reach agreement on a different outcome within six months. See United Nations Committee of Experts on International Cooperation in Tax Matters, 'Secretariat Paper on Alternative Dispute Resolution in Taxation', 8 October 2015, http://www.un.org/esa/ffd/wp-content/uploads/2015/10/11STM_CRP8_DisputeResolution.pdf, page 10.

[36] OECD, '2017 Update to the OECD Model Tax Convention', 21 November 2017, http://www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf, page 21.

[37] OECD, '2017 Update to the OECD Model Tax Convention', 21 November 2017, http://www.oecd.org/ctp/treaties/2017-update-model-tax-convention.pdf, page 21.

[38] OECD, 'Making Dispute Resolution Mechanisms More Effective, Action 14 - 2015 Final Report', 2015, http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/making-dispute-resolution-mechanisms-more-effective-action-14-2015-final-report_9789264241633-en#.Wfx1GmhSw2w#page9, page 10.

[39] United Nations, 'Model Double Taxation Convention', 2011, https://www.un.org/esa/ffd/wp-content/uploads/2014/09/UN_Model_2011_Update.pdf, page 369.

[40] Sol Picciotto, 'International Tax Disputes: Between Supranational Administration and Adjudication', International Centre for Tax and Development, Working Paper 55, August 2016, http://www.ictd.ac/publication/2-working-papers/142-international-tax-disputes-between-supranational-administration-and-adjudication.

[41] Sol Picciotto, 'International Tax Disputes: Between Supranational Administration and Adjudication', International Centre for Tax and Development, Working Paper 55, http://www.ictd.ac/publication/2-working-papers/142-international-tax-disputes-between-supranational-administration-and-adjudication.

ICRICT
Independent Commission for the Reform of International Corporate Taxation

6 December 2018

Dear Sir/Madam,

ICRICT response to the Consultation on an IMF 2019 Analysis of International Corporate Taxation

ICRICT welcomes the opportunity to respond to the IMF's request for input in drafting the new analysis on the international corporate taxation system and its possible future directions.

The Base Erosion and Profit Shifting (BEPS) international reform led by the G20 and the OECD clearly has made progress that would have been thought of as difficult just five years ago. That this pace of change has been possible is a strong indicator of the rise in public interest, and concern, in these matters and highlights the need to be even more ambitious.

While this reform has proposed some solutions for some of the most egregious tax avoidance mechanisms, it has failed to deal with the core mechanism of tax avoidance. The transfer pricing system and other tax avoidance mechanisms remain available to multinationals and are in fact incentivised and legitimised as a result of the BEPS process.

As a Commission, we believe that one of the biggest deficiencies of the BEPS process has been its inability to address the core problem of our global tax system: the separate entity approach to taxation and transfer pricing. Nowhere is this more evident as in its inability to come to terms with the changes brought about by the digital economy, which is increasingly becoming the economy itself.

The reform of the international corporate tax system is at a critical juncture. The OECD has achieved what it could, within the constraints of its mandate, but has shied away from examination of the most fundamental problem. The OECD's ongoing work on the digital economy exposes all the contradictions of transfer pricing to the extreme and demonstrates that it is no longer fit for purpose.

The international community is at a crossroads: continue to tinker at the edges with a broken system designed for the last century or look at solutions designed to fix the problems of this century and deliver a sustainable international tax architecture fit for purpose. The risk is that if we do not fix the current system then disenchantment with the global tax system will feed into the ever-growing distrust of global institutions and the rise of populist politics.

Hence, we have met with international tax specialists and practitioners and considered analyses and proposals to form a diagnosis of the problems and identify solutions.

The current multinationals' tax avoidance structures are conceptually straight-forward: low profits are declared in high-tax jurisdictions, both in developed and developing countries, through the use of limited risk structures (e.g. limited risk distributors/manufacturers), excessive debt and deductions for intangibles, so that the balance of profits is attributed to intellectual property, funding and strategic functions/risks (e.g. global procurement, management, intellectual property related activities) in low tax jurisdictions. As IP and non-intensive labour functions can easily be relocated where it is most tax effective with the current system, multinationals can in practice decide how they distribute their profits across jurisdictions. A system that attributes the large share of its profits to the ownership of intellectual property and the performance of certain functions/risks is also particularly detrimental to developing countries, which are not home to multinationals' headquarters and intellectual property.

Following our first meeting in March 2015, we issued the ICRICT Declaration, with a statement of principles and a series of recommendations for reform. The primary recommendation was that multinationals should be taxed as unitary firms, moving away from the fictitious and ineffective system of transfer pricing based on the arm's length principle. In September 2017 we met again to consider in more detail explanations from specialists on the three main models for unitary taxation: (a) worldwide residence-based taxation, (b) a destination-based cash-flow tax, and (c) formulary apportionment. We concluded that the third was clearly the preferable option, as the other alternatives are not beneficial for developing countries.

Our report A Fairer Future for Global Taxation outlines our reasons for this conclusion, and suggests a Roadmap for moving towards such a system.

A system of **multi-factor global formulary apportionment**, **together with a global effective minimum corporate tax rate**, offers the best method of ensuring that source countries where the activities generating MNE's profits take place receive their fair share of tax revenues from these profits. A global effective minimum tax drastically reduces the financial incentives for multinationals to shift profits between jurisdictions and for countries to cut their tax rates.

The allocation of multinationals' profits between countries for taxation purposes is a fundamentally distributive task. Multinationals are unitary businesses making profits in a global marketplace, where profit can only be achieved through the integration of their activities across jurisdictions, and the value of the multinational as a whole is bigger than the sum of its individual parts.

A simple, formulaic approach would ensure that global profits and associated taxes could then be allocated according to objective factors such as the sales, employment, resources (and even digital users) used by the company in each country, rather than where they locate their different functions (procurement, marketing, funding, etc) and claim their Intellectual Property.

The use of the profit split method to allocate profits can be a first step towards formulary apportionment, but only if the allocation factors used to split the profit are standardised and weighted consistently; else in our view it would create further opportunities for tax avoidance.

In our forthcoming publication, "**Tax avoidance by multinationals: what BEPS 2.0 should look like" (Embargoed copy also enclosed),** we take stock of the positives and negative measures that have been introduced to date as part of the BEPS process and the implications for the continuing reform process required for fair taxation of multinationals.

During the next phase of the BEPS process ("BEPS 2.0") we urge governments represented in the Inclusive Framework, the UN Tax Committee and all multilateral institutions, to move away from the transfer pricing system and towards unitary taxation of multinationals with formulary apportionment and introducing a global effective minimum tax rate.

We value the important role that the IMF can play in this area and we invite you to show leadership so that the international community can work together towards sustainable international tax architecture. We can assure you of our support in all your efforts towards this aim we remain at your disposal should you wish to discuss this important issue further.

Yours faithfully,

José Antonio Ocampo (Chair)
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Eva Joly
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Public Services International
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7th December 2018

Public Services International submission to the consultation on an IMF 2019 Analysis of International Corporate Taxation

Public Services International is a global trade union federation which brings together more than 20 million workers, represented by over 700 unions in 163 countries and territories. Our members, two-thirds of whom are women, work in social services, health care, municipal and community services, central government, and public utilities such as water and electricity.

We are dedicated to promoting high-quality public services in every part of the world. As such, we are committed to reforming the injustice of an international corporate tax system which enables corporations to avoid their fair share of taxes, thus depriving public services of revenue, unfairly shifting taxation onto labour and deepening inequality in society.

The current state of international corporate taxation

We believe that the continued injustice of the current international tax system is one of the driving forces behind the recent rise in public distrust of global institutions and the rise of dangerous populist politics. The international community must stop justifying the foundations of a broken system designed for the last century and look at genuine solutions designed to fix the problems of this century, to deliver a sustainable international tax architecture fit for purpose.

The upsurge in recent reform initiatives and the rise in public interest in tax matters are strong indicators of the need to be more ambitious.

The OECD's Base Erosion and Profit Shifting (BEPS) initiative has underlined the problems of international corporate taxation without addressing their deeper causes. These causes include the failures of the arm's-length principle, pervasive tax competition and the undemocratic manner in which international tax norms are determined.

The OECD has achieved what it could within the limits of its mandate and membership. However, BEPS became inclusive of more countries only late in the process and the OECD remains unwilling to fully confront the problems of the arm's-length principle. It is inevitable that these problems will grow as more of the economy digitalises and intangible assets become increasingly important to corporate profits.

We see a fragmented response by governments which includes BEPS- driven reforms, ad-hoc measures to shore up the domestic tax base (such as digital-economy or diverted profits taxes) and at the same time, yet more tax competition. Some multinationals can be expected to try and game new requirements for economic substance, while continuing to enjoy very low tax rates, by moving a few more staff or assets into tax havens.

Recent cuts to corporate tax rates in the United States are a fiscal disaster which workers and other citizens will be paying for, for years to come. These tax cuts will deepen inequality in the US and encourage corporate lobbyists in other countries to push for yet more tax cuts in response. The IMF's own research finds potentially large and harmful spillover effects on the tax revenues of other countries.[1]

We do see promising signs of the potential for deeper reform, for instance in the European Commission's proposal for a Common Consolidated Corporate Tax Base. However, divisions between European Union countries about how far and how fast to move show the need for a deeper and more concerted global effort, one which recognises the dangers for social peace of failing to tackle abuses of power by corporations.

What needs to happen

There needs to be a much deeper, more concerted and more democratic effort to reform corporate taxation, based on the recognition that if inequality is to be redressed then taxes on capital and the returns to capital must go up, not down. This response needs to include:

- Public country-by-country reporting for multinationals, as well as automatic exchange of tax information for all countries (including the poorest) and public disclosure of the ultimate beneficial owners of corporations. The secrecy and opacity of the offshore system not only enable tax avoidance and evasion but make corporate accountability in general much harder to achieve. This is a serious concern for workers who see their wages and working conditions under threat.

- Moving towards taxation of multinationals as single global entities, based on formulae which balance the interests and needs of poorer and richer countries. For example, a formula weighted too far towards sales could privilege larger and richer countries with bigger markets over poorer ones. We do not favour destination-based profit taxes for the same reason. Residual profit split methods could be used as an interim step towards unitary taxation.

- A recognition that tax competition, rate cuts and tax breaks can drive inequality by holding down taxation of capital at the expense of labour and consumers. Too often, corporations' investment decisions are taken as the starting point for debate about what corporate taxation should look like. The starting point should be that without well-funded states, healthy and well-educated workers and consumers, there will not be profitable markets for corporations to invest in for the longer term. This is why there needs to be a global minimum rate of corporate income tax.

- A democratisation of tax policy-making nationally and globally, with far greater transparency and accountability to citizens and far less scope for corporate lobbyists and vested interests to shape policy behind the scenes. PSI believes that a global tax convention, administered by a well-run tax body (whose logical home would be the United Nations) will be needed to lock in deep reforms to corporate taxation.

We appreciate the opportunity to submit our comments to the consultation and we welcome the initiative that the IMF is taking to think broadly about the future of international

[1] IMF Working Paper WP/18/166. Tax spillovers from US corporate income tax reform. July 2018.

corporate taxation. We hope that the 2019 Analysis will be ambitious in its thinking and acknowledge that at root, the current problems of corporate taxation are not merely technical issues requiring technical solutions, but problems of fiscal justice.

Thank you for the chance to make this submission.

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10 December 2018

Fiscal Affairs and Legal Departments
International Monetary Fund
By email to IMFCONSULTATION@imf.org

Response to Consultation on IMF 2019 Analysis of International Corporate Taxation

Dear Sir / Madam

I am pleased to enclose a response from the Tax Justice Network to your consultation on the IMF 2019 analysis of international corporate taxation, as outlined on your website in October 2018 at https://www.imf.org/external/np/exr/consult/2018/corptaxation/.

The Tax Justice Network is an independent international network, launched in 2003. It is dedicated to high-level research, analysis and advocacy in the area of international tax and financial regulation, including the role of tax havens. It maps, analyses and explains the harmful impacts of tax evasion, tax avoidance and tax competition; and supports the engagement of citizens, civil society organisations and policymakers with the aim of a more just tax system.

From its inception, the Tax Justice Network has sought to expose and to remedy the inherent flaws of international tax rules. The failure of the economically illogical arm's length principle, now widely recognised, results in a systematic distortion in the distribution of taxing rights between countries. That distortion contributes to widening inequalities in tax sovereignty, imposing unnecessary revenue losses on most countries. These losses are disproportionately high for low- and middle-income countries where the human rights damage of foregone public spending is also greatest.

We therefore wholeheartedly welcome this consultation, and the prospect of a more open and international discussion of tax rules – ideally in a globally representative UN setting.

Yours faithfully,

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1. CURRENT STATE OF INTERNATIONAL TAX RULES

> *"A new basis for taxing corporations is also required. A national basis for corporate taxation makes no sense when companies can operate in 150 or more states simultaneously. It is inevitable that taxation problems will arise in circumstances where the company acts globally but taxation is imposed locally… Trading profits will need to be taxed on a unitary basis."*
>
> Tax Justice Network, 2005
>
> *"[O]ur current system is capricious in result, expensive to operate, and permits and even encourages the relocation and minimization of measured taxable income, in many cases divorcing that tax base from real economic activities… Multi-national groups should be taxed on a unitary basis, eliminating the use of the arm's length principle within them."*
>
> Victoria J. Perry, 2017

The country level and international institutional treatment of corporate taxation in a global system is of paramount importance for addressing and redressing inequalities, including economic, gender and racial disparities and the patterns of discrimination they reflect. It is fundamental to enabling the taxing rights of sovereign states and in cementing the bond of accountability between state and citizen which is at the core of the concept of human rights.

International tax rules are at a prolonged point of inflexion, triggered by the global financial crisis that began in 2008. The associated fiscal shock in many high-income countries was exacerbated powerfully by the major economic policy errors that can be grouped together under the broad label of 'austerity'. The resulting cuts to public services and worsening trends in poverty and inequality led to the emergence, for the first time, of a broad international consensus.

Low- and middle-income countries had long suffered from the tax avoidance of multinational companies predominantly headquartered in OECD member countries. Now those OECD members joined the demand for action to limit revenue losses (OECD, 2013, p.11):

> *The G20 finance ministers called on the OECD to develop an action plan to address BEPS [Base Erosion and Profit Shifting] issues in a co-ordinated and comprehensive manner. Specifically, this Action Plan should provide countries with domestic and international instruments that will better align rights to tax with economic activity.*

This consensus on a single aim, to reduce the misalignment between where multinationals declare their profits and the location of their real activity, represented an important step forward. As well as the new fiscal and political pressures after the crisis, this demand was underpinned by the explosion in misalignment that had taken place over the preceding decades. As Figure 1 illustrates, misalignment of US-headquartered multinationals rose from just 5-10% of their global profits in the 1990s, to 25-30% (Cobham & Janský, 2019).

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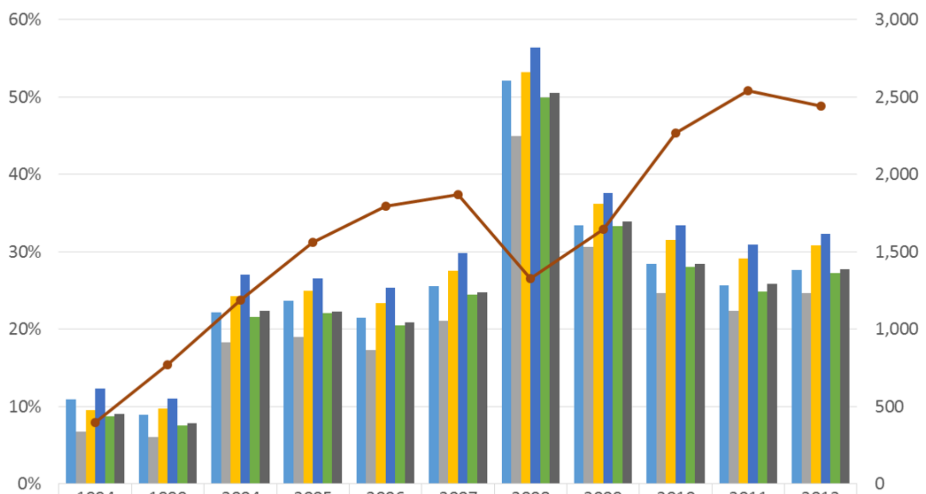
Researchers from the International Monetary Fund's Fiscal Affairs Department have estimated that the revenue losses associated profit shifting are of the order of $600 billion each year, of which $200 billion is due to low- and middle-income countries (Crivelli, de Mooij & Keen, 2016). Researchers at the Tax Justice Network (Cobham & Janský, 2018) used the same methodology with enhanced data from the ICTD-WIDER Government Revenue Dataset to generate a somewhat more conservative estimate of around $500 billion a year in losses globally, and consistently $200 billion for lower-income countries. In both cases, the implied country level losses represent a greater share of overall tax revenues for lower-income countries than for OECD members, due to the international tax rules promoted by the latter and exploited by their own multinationals.

FIGURE 1: PROFIT MISALIGNMENT OF US-HEADQUARTERED MULTINATIONALS



	1994	1999	2004	2005	2006	2007	2008	2009	2010	2011	2012
Tangible assets	10.9%	8.9%	22.2%	23.6%	21.4%	25.6%	52.1%	33.4%	28.4%	25.6%	27.6%
Sales	6.7%	6.1%	18.2%	19.0%	17.3%	21.1%	44.9%	30.7%	24.7%	22.3%	24.7%
Employees	9.5%	9.8%	24.3%	25.0%	23.3%	27.5%	53.2%	36.2%	31.5%	29.2%	30.8%
Wages	12.3%	11.0%	27.0%	26.5%	25.4%	29.8%	56.4%	37.5%	33.3%	31.0%	32.3%
CCCTBtg	8.7%	7.5%	21.6%	22.0%	20.5%	24.5%	49.9%	33.3%	28.0%	24.9%	27.2%
Canada	9.1%	7.9%	22.3%	22.2%	20.8%	24.7%	50.5%	33.9%	28.5%	25.9%	27.7%
Gross profit (US$ billion, RHS)	395.5	768.5	1185.4	1560.7	1792.6	1867.0	1325.0	1646.6	2268.9	2541.8	2440.8

Tangible assets Sales Employees Wages CCCTBtg Canada Gross profit (US$ billion, RHS)

Source: A. Cobham & P, Janský, 2019, 'Measuring misalignment: The location of US multinationals' economic activity versus the location of their profits', *Development Policy Review* 37(1), pp.91-110. Note: Bars reflect the proportion of global profit (shown on left hand axis) which is misaligned with the relevant indicator of activity. 'CCCTBtg' is the compound measure of activity used in the European Commission's proposal for a Common Consolidated Corporate Tax Base, namely a weighted formula comprising sales (one third); tangible assets (one third); and employees and wages (one sixth each). Data is from US Bureau of Economic Analysis.

Sadly, the OECD BEPS process was fatally flawed before it even began – because it excluded, from the outset, any consideration of comprehensive alternatives such as unitary taxation with formulary apportionment. As the Tax Justice Network (2013, p.5) wrote at the time:

> *[T]his piecemeal patchwork approach is a recipe for intensified tax conflict and ultimate failure. The fundamental defect of current international tax rules is that they treat [multinationals] as if they*

were separate entities in each country, dealing with each other at `arm's length'. But this is a fiction: they are unitary bodies under common ownership and control, and they should be treated as such. A new approach is needed, to replace fiction with economic reality.

The failure of the BEPS process is not only widely acknowledged now, but also evident in the policy actions of most countries. The US, having played a key role in limiting the OECD's scope to consider more comprehensive alternatives to arm's length pricing, has introduced a major tax reform that goes well beyond BEPS. The EU has revived its longstanding proposals for a Common Consolidated Corporate Tax Base. The G77 group of countries is seeking with renewed vigour to ensure corporate tax questions are addressed at the UN, rather than the OECD. International discussions of digital taxation, meanwhile, revolve around the appropriate, non-arm's length basis to apply.

The current state of international tax rules is, therefore, one of inflexion and uncertainty. It is clear that the status quo is not sustainable, nor does it have any great support beyond some remaining inertia. It is less clear whether, and how, consensus may emerge on the comprehensive reforms that are required. But it is possible to assess the prospects for change.

2,3. FUTURE OF CORPORATE TAX; UNITARY APPROACHES

An earlier analysis (Cobham, 2014) outlined four possible futures for corporate tax. We revisit these here:

i. **Staying the BEPS course**. The problem for BEPS was always that arm's length pricing is simply not designed to deliver the goal – alignment between the location of real activity and declared profits. The inherent tension made this the least likely future in the medium and longer term, and so it has proved. It is difficult to see how the status quo could be maintained, with unilateral moves increasingly undermining it.

ii. **A bigger fix for BEPS**. A more powerful alternative, broadly within the spirit of BEPS, was set out as requiring common commitment to three broad principles: 'a common tax base (so there is no incentive for arbitrage on the base); minimum tax rates (limiting, though not eliminating, the incentive for arbitrage on rates); and elimination of preferential regimes (such as the patent box)'. While an anonymous official at a major ministry of finance suggested such an approach could eliminate as much as 90% of profit shifting, in practice the BEPS process was unable to deliver even agreement on the elimination of preferential regimes – instead formalising and actually increasing the use of the patent box, for example.

iii. **Unitary tax revolution**. Unitary approaches with formulary apportionment have the obvious advantage of actually delivering on the aim of the BEPS process, since by definition profit is aligned with (the chosen factors of) real economic activity. But the failure to collaborate in the BEPS process suggested that policymakers are likely to be led astray by a misplaced belief in possible benefits to tax 'competition'. The recent weakening of multilateralism has only strengthened the case against comprehensive global agreement on a unitary approach.

iv. **Unitary tax evolution**. As we wrote in 2014, 'A more likely scenario is one where the current system evolves gradually towards something more consistent with unitary taxation.' Two complementary channels through which this could occur were identified: a breakaway group of lower-income countries, seeing in new country-by-country reporting data the profit misalignment of multinationals operating in their jurisdiction, and deciding to switch unilaterally to a formulary apportionment approach; and/or the 'more gradual growth in the diversity of methods allowed under OECD rules and the use of methods that include some profit attribution on the basis of activity, as distinct from' arm's length pricing. Both scenarios offer the possibility of greater tax sovereignty for many lower-income countries.

A specific possibility, proposed by the Tax Justice Network and explored by the Independent Commission for the Reform of International Corporate Taxation, is a formulary alternative minimum corporate tax. This is perhaps the least blunt introduction of a unitary and formulary approach, and as such may be less subject to lobbying pressure from OECD members, multinationals and/or their advisers (ICRICT, 2018, pp.11-12):

> *The Commission also proposes unilateral adoption of formulary apportion as a backstop to arm's-length transfer pricing results. In the absence of global coordination and agreement, an individual country or region could consider implementing formulary apportionment as part of a domestic alternative minimum tax regime. In such a regime, formulary apportionment would determine the income base for computing an alternative minimum corporation tax.*
>
> *The country could define the local corporation tax base by applying a multi-factor formula to a MNE's global income, and compute the minimum tax payable on that apportioned income, for example at 80 percent of the regular corporation tax rate. The minimum tax would be payable if it exceeds the jurisdiction's regular corporation tax payable computed on the MNE's local income as determined under conventional arm's-length transfer pricing methods.*
>
> *Such an alternative minimum tax regime could be enacted as domestic legislation without the need to repudiate existing multilateral agreements and commitments to the arm's-length principle, including the OECD transfer pricing guidelines.*

The much-discussed possibility for a 'BEPS 2.0' could potentially take any of the four paths, and a BEPS 2.0 could also pursue some of the narrower fixes raised in this consultation raises (see following section). The current trajectory is one of divergence, as different powers pursue different approaches. The scope for conflict, not least in relation to the rights to tax US-headquartered multinationals on their profits arising in host countries, is more pronounced than at any recent time.

Greater global cooperation therefore seems unlikely in the short-medium term; but the same pressures that undermine multilateralism at the global level may support greater unity in regional or other collaborative efforts, whether in intellectual reaction or through defensive need. That could see regional or other groupings band together, for example to exert some greater sovereignty over tax policy than is possible through 'competitive' approaches.

Four years on from when these four futures were initially set out, the first (staying the BEPS course) and third (a unitary revolution) remain unlikely. Unfortunately perhaps, the 'bigger BEPS fix' envisaged in the second option has not gained traction. But the fourth option, of a gradual evolution towards unitary approaches, has indeed begun.

4, 5, 6. OTHER APPROACHES AND DIGITAL TAX PROPOSALS

The almost immediate recognition of the BEPS plan's failure has given new life to the longstanding search for alternatives. In the United States, the incoming Trump administration dallied with destination-based approaches, raising their profile beyond anything that the research base could support at that point. The key weaknesses of taking sales as the only factor on which to apportion taxable profits remain clear: above all, the introduction of a border adjustment that might distort trade and could well violate WTO rules, and the systematic favouring in higher-income countries in terms of tax base of distribution (ICRICT, 2018).

Current digital tax proposals too, while remaining incapable of delivering either EU or OECD agreement, rely on an effective apportionment of taxing rights according to the location of sales. As with destination-based approaches, this provides welcome confirmation that arm's length pricing is unable to offer a solution to new multinational structures and processes. At the same time, however, current proposals appear arbitrary and piecemeal in scope, and unlikely to deliver broad improvements in the distribution of taxing rights.

More promising is the return to attention of the European Commission's proposed Common Consolidated Corporate Tax Base, which follows the likes of Canada, the US and Switzerland in applying formulary apportionment for tax base distribution within a jurisdiction (in this case, between the member states of the European Union). The preferred formula reflects both the importance of using factors of economic activity that are relatively immobile and relatively hard to distort (compared to e.g. profit); and the need to balance taxing rights in countries at quite different income levels. In general, employment factors tend to favour lower-income countries (and headcount above payroll); while sales favours higher-income countries, as would be expected. The formula used to apportion tax base between Canadian provinces, an equal weighting of sales and employment, may however provide the best option in terms of fairness and simplicity – not least, since the value of tangible assets is wide open to distortion for tax purposes.

Interim profit split methods (PSM) can offer a way forward if outright unitary and formulary approaches remain too big a shift. In this regard, we commend the submission to this consultation from the BEPS Monitoring Group which proposes the 'adoption of a combination of principles and pragmatism to systematise and standardise the PSM'.

Other work-around approaches can provide some immediate relief, although as with arm's length pricing methods tend to risk a complexity and uncertainty that is always likely to be exploited by large multinationals and their advisers, to the detriment of public revenues in lower-income countries especially.

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8, 9. INTERNATIONAL ARCHITECTURE AND OTHER ISSUES

Current arrangements for international tax cooperation and/or coordination are at the heart of the deep inequalities that characterise the distribution of taxing rights globally. This applies to the failure to include lower-income countries fully in the benefits of automatic exchange of financial information, primarily a tool against individual tax evasion and corrupt practices, just as much as it does to the inability thus far of the international community to deliver meaningful international corporate tax reform against abuse by multinational companies and jurisdictions that act as profit-shifting hubs at the expense of all others.

Recent and historic efforts to reform tax rules have been led by the OECD, a club of rich countries whose members play host to the great majority of major multinational companies and of financial services exporters. Notwithstanding the goodwill of many of the people involved, it is no coincidence that reforms ultimately guided (and constrained) by OECD members have failed comprehensively to address these distortions.

Aside from the technical questions of whether and how to pursue alternative international tax rules, or greater tax transparency, the underpinning question is of who will take these decisions – and all the others that will be needed in the future, as tax behaviours evolve and international policy responses are required.

While it is welcome to see the IMF providing an alternative centre of technical engagement from the OECD on international tax matters, the political legitimacy to provide a globally representative forum for tax policy making can only, in the end, reside with the United Nations. Such a tax body would require a well-resourced and highly skilled secretariat, and the authority to support decision-making. An additional measure, which may be more easily delivered in the short term, would be a UN convention on tax transparency, to ensure universal coverage and inclusion of the ABC of tax transparency:

- Automatic exchange of tax information
- Beneficial ownership transparency (public registers for companies, trusts and foundations)
- Country-by-country reporting (full public disclosure by multinationals, not ultimately by the OECD standard but the technically superior alternative now proposed by the Global Reporting Initiative)

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ANNEX: CONSULTATION ON AN IMF 2019 ANALYSIS OF INTERNATIONAL CORPORATE TAXATION

1. How do you view the current state of the international corporate taxation system?

   For example:

   • What do you see as the main successes or shortcomings of the OECD Base Erosion and Profit Shifting (BEPS) project?
   • How does it affect developing countries?
   • What are your views on recent tax reforms in the US and elsewhere?
   • Are problems with the current principles of international taxation (residence and source bases; arm's length pricing…) becoming harder to deal with?
   • In your view, is the allocation of taxing rights and profit attribution to countries problematic?

2. Assuming that the world continues with broadly the current international tax architecture, what does the future of corporate tax look like?

   For example:

   • How will digitalization and the growing importance of intangibles and "user participation" (e.g., through search engines or social media) affect the system in terms of fairness, efficiency and implementation?
   • How effectively can future tax policy changes be implemented into the existing international architecture?
   • Will tax competition intensify or moderate?

3. Can unitary/formulary methods help address weaknesses of the current architecture? If a full shift to formulary apportionment is not possible, what is your view of using some form of residual profit split in cases where arm's length pricing doesn't work well or make sense?

4. Several proposals include elements of destination-based taxation (i.e. allocating tax base, perhaps in part, to the place of the final sale)? What pros and cons do you see in this, both in principle and in practice? Do you see the current system as already moving towards destination-based principles (e.g. interim digital taxation measures)?

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5. Should tax bases be changed to target only "economic rents"— "excess profits"—leaving the taxation of "normal" returns to the shareholder level (or not taxing them at all)?

   For example, this could entail using a cash-flow tax or Allowance for Corporate Equity or Capital system that allows immediate deduction at the corporate level of all investment costs, or allows an annual deduction for a standard return to invested equity as if it were debt.

6. What do you think of proposals (or reforms such as the recently enacted US "GILTI" provision) to impose some form of minimum corporate income tax?

7. What is your view of taxes targeted specifically at digital activities of various forms?

8. How do you assess current arrangements for international tax cooperation or coordination? Are they adequate to address weaknesses you may see in the current international tax architecture?

9. Please feel free to raise any other issues that you think the IMF paper should address.

Fiscal Affairs and Legal Department
International Monetary Fund
Washington DC, USA

10th December 2018

Dear Madam/Sir

TJNA Submission on Consultation on an IMF 2019 Analysis of International Corporate Taxation

Tax Justice Network Africa (TJNA) welcomes the opportunity to provide input during the consultation phase of the IMF's International Corporate Taxation. TJNA considers this consultation an important step in supporting efforts to reform the international financial architecture that will in turn lead to a reduction in corporate tax avoidance and evasion and thereby provide much needed tax revenue for developing countries. We present our submission below for consideration.

1. On the OECD BEPs Process, its effectiveness, failures, and implications for developing countries

The success of OECD BEPS project is mainly increased awareness and raising momentum to curb tax evasion through fostering tax policy and regulatory reforms in various jurisdictions such as strict rules on beneficial ownership, anti-treaty shopping provisions, transfer pricing regulations among others.

The failures

- Non-adaptability with tax jurisdictions in developing and some other non-OECD countries where technical and infrastructural capacity challenges regarding exchange of information; weak legal frameworks for deterrence, detection and punishment for tax avoidance and evasion exist;
- The threshold for EURO 750millions of annual turnover for Country by Country Reporting is high especially for MNCs operating in developing countries providing opportunity for abuse
- The requirement that information exchanged between jurisdictions must be used only for tax purposes
- Lack of agreement on whether exchange for information should be automatic or should be on request, plus the associated administrative cost of Country by Country reporting and responding to information costs.
- Limited capacity to utilise Beneficial Ownership data for investigation of tax crimes

Regarding transfer pricing, the arm's length principle has failed to deliver results. There is a general agreement to move towards unitary taxation or formulary apportionment. The current rules and norms setting in the international financial architecture has not done developing countries any good. The decision making remains largely disproportionate with developing countries embracing implementation as developed countries set the agenda. TJNA advocates for equal participation of developing countries in the review of the BEPs framework.

2. On the US Tax Reforms and implications for tax competition

The US tax reform will result into resource transfer by companies in developing countries to the US. This will result into lower revenue collections from corporate profits from developing countries which will exert pressure on Governments in such countries to finance the desired programs. As a result, such countries will resort into enforcing other taxes to offset the revenue losses. Such other taxation options may increase the burden on small income earners and contribute to deterioration of the business environment. The US reforms will also trigger global trade wars amongst powerful trade nation's leading to violation of international treaties and consequently distorting the international financial architecture.

The only beneficiaries of this unilateral action are countries with large populations who are also large net importers of US goods will benefit from this process, because such goods will be cheaper. For example, under BEPS action 5, The Foreign Derived Intangible Income (FDII) by US qualifies as a harmful tax practice especially with respect to taxation of intangibles. The proposal to grant US corporations a 37.5 % deduction of deemed intangible income generated offshore where such income has used US to be derived suits characteristics of a direct export incentive to US countries.

Ultimately, the US Tax reforms are tantamount to propagating tax competition.

3. On the Digital Economy

The allocation of taxing rights remains largely unfair considering developing countries. TJNA supports the efforts by developing countries to exercise their taxing rights of MNCs in the digital sector specifically where value creation occurs.

Beyond taxation, TJNA is cautious the digital economy brings great opportunity for value creation across several process value chains, there are inherent risks that need closer analysis. For example, there is a need to understand how MNCs take advantage of loopholes in the current architecture and engage in tax malpractice such tax avoidance, tax evasion, and potentially creating an avenue for IFFs from developing regions.

4. On the Governance of International Tax Reform

If the international rules setting in taxation remain as is, with some countries adopting unilateral policy changes while others embracing the OECD-BEPs inclusive framework, it is most likely that international tax competition will intensify. Such fragmentation generates uncertainty in international business climate and serves to weaken long-term efforts for designing multi-lateral solutions. It is no doubt that unilateral domestic decisions by huge players in international financial architecture have international repercussions. For instance, the 2017 reforms in USA's tax policy, The UK reducing her corporation tax rate by 2%, the proposal for the re-establishment Accra International Financial Centre and Kenya's proposal for the establishment of the Nairobi International Financial Centre among others, provide a breeding ground for tax competition and soft landing for Multi-National Corporations (MNCs) to perpetuate tax avoidance.

The Platform for Collaboration on Tax (PACT) should take consideration of developing countries needs through collaboration with regional tax institutions such as the ATAF and Civil Society. Furthermore, Regional agreements can be used to advance the collaborative agenda on an international tax architecture that takes consideration of the peculiarities of developing countries.

TJNA supports the establishment of an inclusive Intergovernmental Tax Commission under the auspices of the United Nations, where all countries have an equal say in setting international tax standards and the works of the Global Tax Justice movements are a right direction towards promoting tax justice which is TJNAs core mandate.

Yours sincerely,

Jason Rosario Braganza
Deputy Executive Director
Tax Justice Network Africa

Public Services International
Internationale des Services Publics
Internacional de Servicios Públicos
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7th December 2018

Public Services International submission to the consultation on an IMF 2019 Analysis of International Corporate Taxation

Public Services International is a global trade union federation which brings together more than 20 million workers, represented by over 700 unions in 163 countries and territories. Our members, two-thirds of whom are women, work in social services, health care, municipal and community services, central government, and public utilities such as water and electricity.

We are dedicated to promoting high-quality public services in every part of the world. As such, we are committed to reforming the injustice of an international corporate tax system which enables corporations to avoid their fair share of taxes, thus depriving public services of revenue, unfairly shifting taxation onto labour and deepening inequality in society.

The current state of international corporate taxation

We believe that the continued injustice of the current international tax system is one of the driving forces behind the recent rise in public distrust of global institutions and the rise of dangerous populist politics. The international community must stop justifying the foundations of a broken system designed for the last century and look at genuine solutions designed to fix the problems of this century, to deliver a sustainable international tax architecture fit for purpose.

The upsurge in recent reform initiatives and the rise in public interest in tax matters are strong indicators of the need to be more ambitious.

The OECD's Base Erosion and Profit Shifting (BEPS) initiative has underlined the problems of international corporate taxation without addressing their deeper causes. These causes include the failures of the arm's-length principle, pervasive tax competition and the undemocratic manner in which international tax norms are determined.

The OECD has achieved what it could within the limits of its mandate and membership. However, BEPS became inclusive of more countries only late in the process and the OECD remains unwilling to fully confront the problems of the arm's-length principle. It is inevitable that these problems will grow as more of the economy digitalises and intangible assets become increasingly important to corporate profits.

We see a fragmented response by governments which includes BEPS- driven reforms, ad-hoc measures to shore up the domestic tax base (such as digital-economy or diverted profits taxes) and at the same time, yet more tax competition. Some multinationals can be expected to try and game new requirements for economic substance, while continuing to enjoy very low tax rates, by moving a few more staff or assets into tax havens.

Recent cuts to corporate tax rates in the United States are a fiscal disaster which workers and other citizens will be paying for, for years to come. These tax cuts will deepen inequality in the US and encourage corporate lobbyists in other countries to push for yet more tax cuts in response. The IMF's own research finds potentially large and harmful spillover effects on the tax revenues of other countries.[1]

We do see promising signs of the potential for deeper reform, for instance in the European Commission's proposal for a Common Consolidated Corporate Tax Base. However, divisions between European Union countries about how far and how fast to move show the need for a deeper and more concerted global effort, one which recognises the dangers for social peace of failing to tackle abuses of power by corporations.

What needs to happen

There needs to be a much deeper, more concerted and more democratic effort to reform corporate taxation, based on the recognition that if inequality is to be redressed then taxes on capital and the returns to capital must go up, not down. This response needs to include:

- Public country-by-country reporting for multinationals, as well as automatic exchange of tax information for all countries (including the poorest) and public disclosure of the ultimate beneficial owners of corporations. The secrecy and opacity of the offshore system not only enable tax avoidance and evasion but make corporate accountability in general much harder to achieve. This is a serious concern for workers who see their wages and working conditions under threat.

- Moving towards taxation of multinationals as single global entities, based on formulae which balance the interests and needs of poorer and richer countries. For example, a formula weighted too far towards sales could privilege larger and richer countries with bigger markets over poorer ones. We do not favour destination-based profit taxes for the same reason. Residual profit split methods could be used as an interim step towards unitary taxation.

- A recognition that tax competition, rate cuts and tax breaks can drive inequality by holding down taxation of capital at the expense of labour and consumers. Too often, corporations' investment decisions are taken as the starting point for debate about what corporate taxation should look like. The starting point should be that without well-funded states, healthy and well-educated workers and consumers, there will not be profitable markets for corporations to invest in for the longer term. This is why there needs to be a global minimum rate of corporate income tax.

- A democratisation of tax policy-making nationally and globally, with far greater transparency and accountability to citizens and far less scope for corporate lobbyists and vested interests to shape policy behind the scenes. PSI believes that a global tax convention, administered by a well-run tax body (whose logical home would be the United Nations) will be needed to lock in deep reforms to corporate taxation.

We appreciate the opportunity to submit our comments to the consultation and we welcome the initiative that the IMF is taking to think broadly about the future of international

[1] IMF Working Paper WP/18/166. Tax spillovers from US corporate income tax reform. July 2018.

corporate taxation. We hope that the 2019 Analysis will be ambitious in its thinking and acknowledge that at root, the current problems of corporate taxation are not merely technical issues requiring technical solutions, but problems of fiscal justice.

Thank you for the chance to make this submission.

Rosa Pavanelli
General Secretary,
Public Services International

Gabriel Casnati, Organización que representa: Internacional de Servicios Públicos, Brasil

1. ¿Cuál es su opinión sobre el estado actual de del sistema de tributación internacional de las empresas?

Sobre el BEPS en un paso en la direccion correcta, inedito en la humanidad; aunque sea muy debil para representar los países afuera del G20/OCDE; en el tema de las exensiones fiscales y con la cuestión de no tributar las multinacionales como entidades unicas, que es un fallo enserio.
Los países en desarrollo son los mas prejudicados, claro, con la grande evasión fiscal y beneficios que las empresas reciben por un sistema lleno de agujeros a nivel internacional.

2. Suponiendo que en el mundo siguiera rigiendo en general la actual arquitectura tributaria internacional, ¿cómo será el panorama futuro de la tributación de las empresas?

Claramente ese modelo actual no es sostenible; la tendencia hoy es una menor taja de tributacion a grandes empresas; y tajas más altas a las clases trabajadoras y pequeños empresarios.

3. ¿Pueden los métodos de tributación unitaria/distribución formularia ayudar a subsanar las deficiencias de la actual arquitectura? Si no es posible adoptar plenamente una distribución formularia, ¿qué opina de emplear algún tipo de método residual de partición de utilidades en los casos en que el principio de precios de mercado no funcione correctamente o no sea aplicable?

De total acuerdo; de hecho también no es un modelo perfecto, pero disminuye mucho las distorciones de tributar las empresas donde ellas generan ganancias de hecho.

4. Varias propuestas incluyen elementos de tributación basada en el lugar de destino (es decir, asignar la base imponible, quizá en parte, al lugar de la venta final). ¿Qué ventajas y desventajas le parece que conlleva este tipo de tributación, en principio y en la práctica? ¿Le parece que el sistema actual ya está dando un giro hacia los principios de tributación por lugar de destino (por ejemplo, las medidas provisionales de tributación digital)?

No me parece que el sistema ya está dando un giro en ese sentido; de hecho, es muy importante considerar ese punto, pues los paises en desarrollo suelen consumir más obtener la sed de importantes empresas. O sea, un giro hacia una tributacion en el destino ayuda a disminuir las brechas entre paises productores y consumidores.

5. ¿Deberían modificarse las bases imponibles para que se centren únicamente en las “rentas económicas”— “utilidades excedentarias”— y debería restringirse la tributación de las rentas “ordinarias” solo al nivel de los accionistas (o eliminar la tributación de estos)?

Es una opcion interesante pero aun no tenemos una posicion cerrada sobre eso.

6. ¿Qué opina de las propuestas (o reformas como la disposición sobre ingresos intangibles globales sujetos a baja tributación, o “GILTI” por sus siglas en inglés, recientemente adoptada en Estados Unidos) para aplicar algún tipo de impuesto mínimo a la renta de las empresas?

La reforma tributaria de los EEUU puede ser una buena respuesta a corto plazo, pero en medio y largo plazo es una reforma bien regresiva, que debe ampliar las inequidades sociales y perder plata de inversion social a nivel de Estado.

7. ¿Qué opina de los impuestos focalizados específicamente en diversas formas de actividades digitales?

Es necesario pensar en eses impuestos por dos motivos principales (Entre otros): esas empresas son las más grandes del mundo (apple, microsoft, facebook, alphabet etc) y pagan una taja de impuesto promedio demasiado pequeña, muchas veces menor que de ciudadanos promedios de clase media y casi inexistente en comparacion con cuanto las mayores empresas de otras epocas pagavan; otro mundo es sobre la libre competencia, esas empresas son casi monopolios en sus áreas y se benefician de su propria naturaleza digital para manipular las sedes y operaciones de la empresa para crear una estructura ficcional de sede en jurisdicciones que casi no cobran tributos.

8. ¿Qué opina de los actuales mecanismos de cooperación o coordinación tributaria internacional? ¿Son adecuados para subsanar las deficiencias que puede detectar en la actual arquitectura de tributación internacional?

Definitivamente no. Aun son experiencias muy iniciales. Deberia establecerse un órgano a nível de UN donde todos los paises puedan tener voz y voto, en una estructura de cooperación internacional sobre el tema.

9. Sírvase mencionar cualquier otra cuestión que le parece que debería abordar el estudio del FMI.

Los beneficios fiscales para sectores agresivos a nivel laboral/ambiental, que muchas veces evaden/eluden plata de sus ganancias o poco generan en cambio y alimentan corrupcion publico-privado.

Abraços,

Gabriel Casnati

ISP/PSI Interamerica
Oficina Regional - Regional Office

A response to the Consultation on an IMF 2019 Analysis of International Corporate Taxation

Professor Richard Murphy[i] and Professor Andrew Baker[ii]

December 2018

This submission

We are pleased to submit observations in response to your call for evidence on tax spillovers made in October 2018 at https://www.imf.org/external/np/exr/consult/2018/corptaxation/

The submission is made jointly by Professor Richard Murphy of City, University of London and Professor Andrew Baker of the Sheffield Political Economy Research Institute at Sheffield University, both in the United Kingdom.

We are the authors of the first peer reviewed journal paper on tax spillovers, a copy of which we attach. This will be published in Global Policy[iii] in 2019.

The policy recommendations in that paper are as follows:

- Systematic country by country tax spillover analysis should be undertaken in a multilateral process overseen by existing international organisations;
- Such an exercise should not be exclusively quantitative, but should involve a substantial qualitative process, involving reporting and assessing of a wide range of tax practices and processes;
- Such an exercise should be informed by the aim of reducing the harm states do to their own fiscal autonomy and that of other states as a practical element of an effective international moral harm convention on taxation;
- Spillover assessments should be driven by an understanding that the purpose of corporation and capital gains taxes is to defend and buttress tax systems as whole;
- To be comprehensive spillover assessment should consider spillovers between and within tax systems covering the following areas: income tax; corporation tax; capital gains tax; social security; tax politics; tax administration; company and trust administration; and international agreements;
- Spillover assessment is therefore domestic as well as international and should revolve around three forms of assessment: domestic spillovers; international risks generated by a jurisdiction; international vulnerabilities of a jurisdiction;
- Professional assessors conducting spillover analysis should collect impressions about current tax practice through wide ranging stakeholder consultations, including interviews and surveys to inform their judgements, in a process similar to the corporate governance ROSCs conducted by World Bank Staff;
- Numerical scores should be allocated on a 1 to 5 scale using such a method, but field notes should also translate into a more qualitative style report assessing and reporting on tax practices and the spillover risks associated with particular jurisdictions, and should contain targeted policy recommendations;
- Different IOs have different expertise, but the IMF, the OECD, the UN and the World Bank should all feed into the precise design of the exercise, with the World Bank possibly being best placed to carry out the actual spillover assessments through a qualitative effort.

We have written guidance on how our suggested approach to tax spillovers might be used in practice, and have undertaken an early draft spillover appraisal of the tax system of the United Kingdom, applying our framework. We attach drafts of both these documents to this submission.

We give out explicit consent for our submission to be published. We shall be pleased to discuss it with you.

Richard Murphy and Andrew Baker

10 December 2018

Consultation responses

1) How do you view the current state of the international corporate taxation system?

For example:

• What do you see as the main successes or shortcomings of the OECD Base Erosion and Profit Shifting (BEPS) project?

The BEPS process was not without its merits, the biggest of which we would consider to be the recommendation of country-by-country reporting. We would simultaneously suggest that the OECD's promotion of systematic automatic information exchange between countries is of great importance. However, we think there were also major weaknesses in the process. In particular, it assumed that the existing structure of international tax relations and the basis on which multinational corporations should be taxed should remain intact. This means that:

- The weaknesses that exist in the structure of international tax agreements continue to exist;
- More importantly, the OECD's arm's length basis for the taxation of multinational companies has remained intact. This means that these entities continue to be taxed on the basis of the fiction that they are made up of independent entities, the existence of each of which should be assumed to be commercially justified, when there is significant evidence that this is not true.

Our suggestion is, then, that what OECD BEPS did was place a 'sticking plaster' on the existing system of international taxation rather than stand back and ask what the real weaknesses and spillovers within the existing tax system were, which would have identified the existing tax treaties and the arm's length pricing method as issues to be addressed, rather than to be retained. We feel, then, that there was a systemic failing in the BEPS process.

• How does it affect developing countries?

The opinion of developing countries was largely not heard during the development of the BEPS process, which was designed for the primary benefit of OECD member states. Many developing countries make this point, emphasising that at present many of them will be denied the benefits of country-by-country reporting which was always intended to be for their benefit from the time it was created by civil society in 2003. In addition, the real problem of how to supply the resources required for developing countries to tackle the issues that they face, most especially with illicit financial flows, was not addressed by BEPS. This, again, implies that there was a failure to undertake a proper qualitative spillover analysis before BEPS was put in place.

• What are your views on recent tax reforms in the US and elsewhere?

The US tax developments have been put in place for the sole benefit of the USA. They have, therefore, been designed without any consideration for the spillover effect that they might have on countries outside the USA. It so happens that some of those spillovers, such as imposing minimum tax rates, might have international benefit. But overall the continuing isolation of the US tax system from that used by the rest of the world is a matter of considerable concern.

The risk of tax spillover effects is minimised when there is a high degree of cooperation between international tax systems with the intention of encouraging tax compliance i.e. the payment of tax at the rate right, in the right place, at the right time where 'right' means that the economic substance of the transactions actually undertaken is reflected in the form in which the transactions are reported for tax purposes.

Using this logic the problems created by the USA are significant. Corporation tax does, of course, have a role in assisting states achieve their revenue raising objectives, but it also has an essential role as a backstop to income taxes. This is a defensive role. A corporation tax should ensure that there is the lowest possible leakage from income tax systems by the diversion of income into corporate entities. When there is inconsistency between corporate income tax systems the risk that this backstop fails increases. This is especially true when any corporate tax system either directly or indirectly encourages the tax interaction between the corporation and its individual shareholders to take place through capital transactions. This can happen when profits are retained to save tax but the resulting increasing net asset worth of the entity is reflected in an increase in its stock price, which is then subject to taxation as a capital gain, usually at lower taxation rates. It can also happen via share buy backs, often with the same net result. This appears to be a particular characteristic of the US tax system both before and after reform, which is then undermining the US tax system as a whole via this spillover effect.

This in turn has a spillover effect on the tax system of other countries because of the spillover of US tax politics on other countries and the pressure this brings to bear on their tax systems. We believe that this is the type of risk that multifaceted qualitative tax spillover analysis helps identify. This encourages our promotion of the use of that system.

• Are problems with the current principles of international taxation (residence and source bases; arm's length pricing…) becoming harder to deal with?

The current international system for taxing corporations, in particular, is based on an economic and legal fiction. This fiction is that all the entities that make up a multinational group of companies should be considered to be independent, commercially justifiable corporate entities whose transactions are all entered into for the sole purpose of pursuing its own profit maximisation, which task it fulfils by trading at market prices for the benefit of its shareholders, to whose identity it is, however indifferent.

This assumption is not true. The subsidiary companies are not indifferent to the identity of their shareholders: they exist solely to serve those shareholders purpose, which need not be the maximisation of the profit of that entity in isolation. In addition, they act solely in accordance with the instructions provided by those shareholders. If that means that the company does not maximise its profit, or does not trade at market prices, but for the benefit of the group as a whole, then that is what they will do. That is the actual purpose for which they exist. And for that reason there is no requirement that a subsidiary have any commercial substance at all, at least in its own right: it may exist solely to ring fence a liability, for example; or to delineate an activity for purely regulatory purposes; and it might just as easily exist solely to assist the mitigation of a tax liability for the group of which it is a member.

The presumption that arm's length pricing is in any way appropriate in this circumstance, or that there need be a separate profit motive, is then wholly inappropriate. If that profit motive exists it is driven by the board of the corporate entity as a whole, which will not, by any means, record all the income arising in the entity on the basis of separate entity accounting.

The accounting profession and company law did recognise this fact a long time ago: consolidated accounting for corporate groups has been commonplace for about 70 years. Nonetheless, despite a steady move towards basing taxation liabilities on accounting profits this fact has not been reflected in tax law.

This has largely been the result of taxation politics. There has been a failure at international level to agree to a change to the system of taxing rights over multinational companies created by the League of Nations in the 1920s and 1930s. It is important to note that at this time consolidated accounting was rare: the data to tax on a group basis did not always exist. It was unsurprising that a separate entity method of taxation was adopted in that case. But since the practice of accounting has moved on many decades ago it no longer makes sense, barring the fact that the national politics of this issue, and the practices of the OECD have been heavily influenced by extensive lobbying from those with a vested interest to maintain the status quo.

Those vested interests include:

- Multinational corporations themselves, who have clearly benefited from the ability to avoid tax that the current system has created;
- The tax havens, whose well being is at least in part based on the relocation of corporate profits to these locations, with their credibility and legitimacy being even more closely associated with this activity; and
- The firms of accountants (in particular) who have made it a specialist business to advise on the creation of so-called 'transfer prices' that supposedly reflect market prices when there is in fact no market in existence for many of the activities that take place in the internal trades recorded by the subsidiaries of multinational corporations. The profits that they make from

being the controllers of the vast majority of the intellectual property associated with this activity are likely to be prejudiced by any change to this tax basis.

It should be noted that similar problems exist with regard to the source and residence basis of taxation when it comes to corporations. Whilst source bases of taxation can be hard to dispute in some cases (for example, the extractive industries) tax residence is largely a matter of choice for the subsidiaries of multinational corporations, and even those corporations themselves. This opportunity is extensively gamed at cost to all nations, but most especially source states, against whose interests the standard OECD double tax agreement is biased, particularly with regard to limitations in tax withholding. This gaming undermines the credibility of the system, whatever the intention behind its creation. Further tax spillover effects are created as a result.

The means to tackle these spillovers exists. Country-by-country reporting has indicated the possibility of this. The fact that it (uniquely) originated in civil society[iv] and has not in any way been endorsed by the accounting standard setting establishment and has been resisted by the largest firms of accountants and auditors does indicate that the obstacle to progress that tax professionals present, as noted above, is real. Country-by-country reporting (CBCR) does, using the minimum number of necessary variables to indicate economic activity (which might, it should be noted, need to be extended in the case of extractive industries activity and, maybe, banking), suggest where it is likely that the economic substance of activities is located. Ideally CBCR would report by country:

- Sales by country, separated into both third party and intra-group transactions, on both a source and destination basis;
- Labour, both by head count and total employment cost including the cost of benefits in kind and secondary forms of payment such as share options;
- The cost tangible asset investment by location excluding intra-group balances;
- Shareholder funds;
- Profit before tax;
- Current tax due;
- Current tax paid.

These elements could then be used to apportion the profits of a multinational corporation to states by formulaic calculation. The question of profit apportionment is then resolved. The consequence is that the state to which the profit is then allocated is liberated to charge whatever tax rate it wishes. This, it should be noted, would not end tax competition. States might still offer low corporation tax rates to induce the inward relocation of labour or tangible investment, in particular, but at least tax competition might then take place on the basis of the economic substance of transactions, as both market practice and economic theory might suggest appropriate. This is the optimal solution to resolving the problem of apportioning taxation rights.

Alternatively, and as an interim step, states might wish to adopt an ‘alternative minimum corporation tax’[v]. This would require a calculation based on available CBCR data, as noted above, to determine the proportion of total multinational group profits (declared on on accounting basis if not otherwise capable of determination) attributable to a jurisdiction. This would then be subject to a deemed effective tax rate that might be a high proportion of the standard corporation tax rate of the jurisdiction in question. If the resulting sum was higher than the tax due based on declared profits then it is suggested that the difference be charged as an excess charge. It is likely that this would only be an interim step whilst a full apportionment basis for corporation tax was agreed internationally to tackle the spillover effects the current system creates.

• In your view, is the allocation of taxing rights and profit attribution to countries problematic?

As noted above, we do think this is the case. We have outlined our solutions.

2) Assuming that the world continues with broadly the current international tax architecture, what does the future of corporate tax look like?

For example:

• How will digitalization and the growing importance of intangibles and "user participation" (e.g., through search engines or social media) affect the system in terms of fairness, efficiency and implementation?

The inability of the existing corporation tax system to reflect the economic substance of the activities (and accounting) of a modern corporation has already been noted. This is particularly true with regard to digital companies, where the ability to exploit the current international tax architecture to avoid corporate income tax has become extreme, and a core part of the business model of the monopolistic entities that now tend to dominate segments of this market.

In the face of the apparent inability of that international tax architecture to respond to the stresses that these tax spillovers have created local solutions are being sought, most of which are based on taxing turnover in some way, even if turnover is not, per se, an indicator of the capacity of the corporation to pay tax.

This move is unlikely to impact the corporation itself given that the incidence of the charge is likely to fall onto those paying for the corporation's services given the monopolistic, or at least oligopolistic, nature or the price setting activities of these entities.

The consequences of the failure to adapt the corporation tax system to need and its fracturing as a result has significant spillover effects. In particular, calls for the abolition of corporation tax itself might arise, which would remove its quality as a mechanism for reducing spillovers in the first instance.

Second, the corporate tax base will be shifted towards consumers through the imposition of what is, in effect, a new sales tax, the incidence of which will impact consumers and not the corporate entities charged with collecting it.

Third, this will increase, and not decrease spillover effect. In particular the tax system may well become more regressive. It will also be more heavily biased in favour of large corporations and against smaller ones, who consume the services if the major digital companies.

Finally, the system will be more fragmented rather than less, and this always increases opportunities for abuse.

The need is for a unitary apportionment formula model for tech companies where usage rather than sales becomes the variable for profit apportionment related to revenue. Alternatively, minimum corporation tax systems should instead be adopted by countries when seeking additional revenue from these corporations since the spillover risks are much lower.

• How effectively can future tax policy changes be implemented into the existing international architecture?

For the reasons noted previously, the existing tax architecture is life expired. The time for radical reform has arrived. Existing tax policy cannot be delivered using it. Future tax policy is beyond its reach. An early twentieth century system cannot meet the needs of international tax nearly a century later.

• Will tax competition intensify or moderate?

It is unlikely that a definitive answer to this question can be supplied because there are too many variables to consider. However, this being noted, it is likely that the fracturing of the system that is now being seen with regard to tech companies will increase the scale of tax competition. The adoption of unitary apportionment methods of tax allocation will not, as noted, eliminate that competition. That is not the aim. It will however mean that the competition in question will be for the location of actual factors of production and not the artificial ones that drive the existing architecture of international taxation.

3) Can unitary/formulary methods help address weaknesses of the current architecture? If a full shift to formulary apportionment is not possible, what is your view of using some form of residual profit split in cases where arm's length pricing doesn't work well or make sense?

We have already largely addressed this issue.

We do not think that universal adoption of a unitary method is a pre-condition of its use: it can be rolled out using more and more commonplace alternative minimum taxation methods.

A residual profit split method is not in any way an acceptable alternative method to unitary apportionment. This is because a residual profit plot method assumes that the corporate structure in use was created for commercial purpose. As previously noted this will be an inappropriate assumption in many, if not most, cases. As such the method is bound to seek to apportion profit on a basis that does not reflect the economic substance of transactions that have taken place and that means it is inappropriate for use.

4) Several proposals include elements of destination-based taxation (i.e. allocating tax base, perhaps in part, to the place of the final sale)? What pros and cons do you see in this, both in

principle and in practice? Do you see the current system as already moving towards destination-based principles (e.g. interim digital taxation measures)?

These methods are most associated with the work of Prof Michael Devereux and Pro Rita de la Feria. We can see no advantage to the proposals that they have made. In essence they have suggested that corporation tax be charged as if it was a value added tax arising at the point of sale having made a deduction for the cost of labour, which would not be available in a VAT system. The problems arising include (but are not limited to):

- The fact that this is, in all but name, a VAT reveals the principle weakness in this proposal. VAT is a deeply regressive tax when considered in proportion to income and wealth (which should be the only basis on which the progressiveness or otherwise of a tax system is appraised, despite contrary opinion from some). This tax would, then, be counterproductive to the objective of most tax systems, which include the aim of reducing income and wealth inequality. Instead it would actually exacerbate both. This is a substantial spillover impact;
- By shifting the tax due to the point of final sale taxing rights would also automatically flow to the countries with the highest levels of final consumption, and these are, of course, the richest countries in the world. The fair apportionment of the tax base within the world community would, then, cease to exist. International inequality would increase as a result. This is an unacceptable spillover effect of this proposal;
- The proposed system could be substantially gamed by the use of franchise sales operations under supposedly third party ownership that were required to buy from a manufacturing group's international sales outlet located in a jurisdiction deliberately setting a low or no tax rate to abuse this new arrangement. Anti-avoidance measures might, to some degree, be possible to tackle this possibility, but they would be complex and potentially very hard to enforce. It is entirely possible that this system might, then, actually increase international tax abuse rather than reduce it, and in the process reduce corporate tax yields considerably;
- This proposal shifts the incidence of corporation tax from capital onto consumers. This is not the intention of corporate taxation and, in our opinion, the actuality of most current corporation taxes[vi]. We think the move unacceptable;
- This measure does, by shifting the incidence of the corporation tax onto sales, remove the backstop quality of corporation tax in supporting the income tax. As a result tax spillovers will increase considerably. This will not just be in general but also in particular, not least because it is not at all clear how this system would handle the income of a company derived largely or entirely from investment sources. Because of this weakness it is likely that income and wealth inequalities within jurisdictions will be increased by this proposal;
- In administrative terms this tax would severely prejudice exporters within the SME sector, whose administrative burdens would increase considerably as a result of having to account for tax in each of their destination markets. This makes little sense when these sectors need encouragement to partake in trade. The spillover consequence of the proposal would be to reduce international trade and competition and concentrate markets even more than at present.

In summary, we can see no merit to these proposals.

5) Should tax bases be changed to target only "economic rents"— "excess profits"—leaving the taxation of "normal" returns to the shareholder level (or not taxing them at all)? For example, this could entail using a cash-flow tax or Allowance for Corporate Equity or Capital system that allows immediate deduction at the corporate level of all investment costs, or allows an annual deduction for a standard return to invested equity as if it were debt.

We see no merit to these proposals:

- As we have explained in our journal paper for Global Policy, which is attached to this submission, corporation tax exists as a backstop to income tax. Its primary purpose is to prevent the diversion of the earnings and gains of those who do not need all their income to meet their regular outgoings into corporations and so avoid taxation altogether. The proposal noted in this question has the exact intention of undermining this backstop effect. As such it might significantly increase spillover effects and undermine both income tax and capital gains tax yields as a result. In that case income and wealth inequality will be directly increased by this proposal and we can see no merit in doing that. This is not just for social reasons: the resulting loss of taxation revenues would, we suggest, likely lead to reduced government spending and so growth.
- We have further reservations. The first is that there is no real evidence that reduced corporation tax rates do result in increased investment.
- Nor is there evidence that increased dividends necessarily boost consumption: by definition they simply reallocate the legal ownership of capital as many of those who own it do not need additional income to meet their needs.
- There is also a technical objection. Even if the income of companies was distributed (and it is more likely to be accumulated to eventually be taxed as gains) there is often considerable difficulty in identifying the owners of corporate entities. New information sharing arrangements are unlikely to entirely solve this problem. Existing corporation tax arrangements overcome this problem by effectively acting as a tax deduction at source, so ensuring some revenue collection, even if not all that due is necessarily eventually paid. As such the corporation tax also has positive spillover effects for tax administrations in undertaking their work.

As such we see no merit in this proposal.

6) What do you think of proposals (or reforms such as the recently enacted US "GILTI" provision) to impose some form of minimum corporate income tax?

We have previously noted our support for an alternative minimum corporation tax system as a means of progress towards a unitary apportionment taxation system. The US proposal has weaknesses, if only because it has been developed in isolation and without any apparent consideration of its spillover effects, but in broad principle we support the creation of minimum corporate income tax systems.

7) What is your view of taxes targeted specifically at digital activities of various forms?

We have made our observations on such taxes previously, as well as the reservations we have about them and the alternatives that we think are available.

8) How do you assess current arrangements for international tax cooperation or coordination? Are they adequate to address weaknesses you may see in the current international tax architecture?

There are major weaknesses in the current arrangements for international tax cooperation. Whilst there is no doubt that the OECD has used its best endeavours on the Base Erosion and Profit Shifting project, the OECD does rightly suffer from the description of being a 'rich-countries club'. Its members all largely fit that description and some BRICS states and the G77 are very largely excluded from its considerations, whilst tax havens are over represented in many of its activities. It does, then, fail to reflect the reality of a world where population, growth and even profits are really shifting. It also, because of its long-term very close ties to the business community who are dedicated to the maintenance of its (as previously noted) artificial basis for international taxation of multinational corporations, suffer from reputational risk from close association with the very interests that need to lose relative power in any new international tax architecture.

If, as we think appropriate, the international tax architecture should reflect the interests of those who are impacted by it then all those who are stakeholders within it must be participants in the process by which it is created and maintained. This, then, requires representation from:

- All countries, with long term funding and training provided to those with limited resources to participate;
- All relevant stakeholder groups, and not just large business. This would require participation from:
  - Small and medium sized entities;
  - Civil society groupings;
  - Trade unions and other employee groups;
  - Consumer groupings;
  - Regulators, including those impacted by, but not directly involved with, corporate income taxes such as local authorities.

We suggest the provision of funding in all cases: access is too important to be compromised by the absence of resources.

We suggest that United Nations oversight might assist this process.

We do not object to a continuing role for the OECD in providing expertise and input.

An international tax court, ruling publicly, is a necessary condition for the open operation of this system, so that disputes can be seen to be openly and fairly resolved.

9) Please feel free to raise any other issues that you think the IMF paper should address.

We attach three notes to this submission.

The first is a journal paper on the creation of an alternative spillover methodology to that proposed by the IMF in 2014. This is the first refereed academic paper on tax spillover and the first to propose a practical method, or easily administered tool-kit, for conducting national level spillover analyses. We welcomed the IMF initiative in that paper, and see merit in what it suggested. However, we also note the limitations on data availability to undertake country level quantitative assessments. In addition, we think the current conception and definition of spillovers is too narrow, because of efforts to model and measure it quantitatively. In our opinion spillovers can take domestic form between different taxes as well as international ones, and spillover effects are not solely restricted to corporation tax.

The proposal we have made suggests that spillovers might be appraised qualitatively, as well as where possible quantitatively. To achieve this goal we have proposed a minimally normative test for appraisal of the impact of any one part of a tax system on another part, which is that the part being considered should not cause harm to any other element of the same system, or elements of other countries' tax systems. We think this a sufficient criterion to guide a qualitative process.

We suggest that spillovers should be appraised in three ways. In the first instance domestic spillovers should be appraised i.e. the impact of the domestic tax system on itself should be considered. Thereafter the risks a tax system generates for other tax systems should be appraised. Finally, the tax spillover vulnerabilities a jurisdiction has to the tax systems of other states needs to be appraised. This is, a measure of tax spillover risk emanating from external sources.

In broad terms we suggest similar methodologies in each case. Very low risk is indicated by a score of 1 and high risk by a score of 5.

We suggest that risk be much more broadly based than the IMF 2014 methodology suggested. This is a merit of a qualitative system that is very hard to reproduce in a quantitative method. It is our suggestion that eight issues, comprising four taxes and four other functions be considered. The taxes are as follows:

- Income taxes
- Corporate income taxes
- Social Security and similar taxes
- Capital gains taxes

Social security is included because it is frequently of considerable domestic importance. Capital gains tax is included as a proxy for taxes on wealth, but also because, like corporation tax it was originally introduced as a back stop to income tax and is inherently, as a result, an anti-spillover measure. Value added taxes might be of considerable revenue significance but have not been included because they tend to have limited interaction with direct taxes domestically and rarely have international impact by the nature of their design.

The administrative and other systems considered are as follows:

- Tax politics. This measure appraises whether or not the politics of a jurisdiction are broadly supportive of tax compliance, or not. Matters to be considered might include attitudes to tax competition, for example.
- The tax administration. This considers, for example, whether this administration is adequately funded; is free form corruption; is fair to taxpayers and whether or not it is also dedicated to tax compliance through fair process.
- The company and trust administration. This indicator considers whether these administrations support the tax system by assisting the identification of those likely to have tax liabilities arising as a result of their participation in the structures that these organisations regulate;
- International agreements. This indicator considers whether or not cooperation of the required sort really exists to promote tax compliant taxpayer behaviour.

When these arrangements are considered the results are, using our methodology, plotted in a grid that has an appearance such as this (which is that for international tax spillover risks created by the UK):

United Kingdom international tax spillovers: risk to other countries from the UK	The issue in other countries										
	Tax spillovers	Income tax	Corporation tax	Capital gain tax	Social security	Tax politics	Tax administration	Company and trust administration	International agreements	Total	Sub totals
Issue being assessed for the UK	Income tax	4	1	2	2	4	2	2	4	21	94
	Corporation tax	5	5	4	2	4	5	4	4	33	
	Capital gain tax	3	2	3	2	4	4	2	4	24	
	Social security	2	2	2	2	2	2	2	2	16	
	Tax politics	4	5	4	2	5	4	5	4	33	129
	Tax administration	4	5	4	2	4	4	4	4	31	
	Company and trust administration	5	5	5	4	5	5	5	5	39	
	International agreements	4	4	3	2	3	3	4	3	26	
	Total	31	29	27	18	31	29	28	30	223	223

We have colour coded the risks to highlight where they arise.

The second document that we attach explains our approach to this methodology in more depth.

The third is a sample appraisal of the UK prepared using this methodology. We stress that this is a draft view at present and not necessarily one that we think would necessarily be replicated if an organisation such as the IMF were to use this methodology. We do, however, think it important because what it makes clear is that a tax spillover appraisal of the sort that we suggest almost necessarily results in the creation of recommendations on the steps that might be taken to reduce tax spillover risk at all three levels that we suggest should be appraised.

We believe the framework we propose and lay out in these documents offers a practical way of conducting country level spillover analysis that has several advantages. First, it captures many of the things missed by more quantitative approaches reliant on official data and established data sets. Second, it is guided by the objective of identifying, evaluating and discouraging forms of tax competition that potentially harm other states, rather than simply being an exercise in measurement for measurement's sake. Third, the framework provides a comprehensive reading of the diverse elements of spillover as a multi-faceted and multi-directional phenomenon. Fourth, these different forms of assessment are necessary because states can be both aggressors and generators of risk, but also vulnerable to spillover risk, to varying degrees. Fifth, the qualitative reports the framework generates can be both diagnostic and remedial in function, identifying priority policy reform recommendations to reduce spillovers. Sixth, the framework can act to disincentivise the aggressive tax competition that can cause spillover effects for others, by attaching some reputational risk to such strategies.

We would be happy to discuss this submission and the tax spillover appraisal procedure that we propose with you.

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Endnotes

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Inputs for the Consultation on an IMF 2019 Analysis of International Corporate Taxation.

By Raghavendra Guru S & Ahamarshan JN

Special Focus Area: **Health related food taxation**

1. How do you view the current state of the international corporate taxation system?

   Health related food taxation (HRFT) is a tax to contain Non communicable diseases (obesity/diabetes/CVD etc.) and to finance Universal health coverage . The tax policy studies should take into account following details that will provide the fundamental understanding of the problem and prevent Inappropriate risk pooling.

   Global Issue: Internationally, the multinational food companies that cause health problems accumulate profits elsewhere while the local governments have to pick up the costs of public health. The above problem is similar to Base Erosion and profit shifting where it costs the country in terms of healthcare expenses without adequate matching revenue. The deterioration in human capital due to health conditions also results in low productivity.

   Foundations of tax policy: Current health related food tax is a product of both medical science (Allopathy/western medicine) and economics. With obesity & other Non-communicable diseases being one of the biggest market failure, there is an urgent need to look at medical practices like Yoga (Economics + Allopathy medicine + Yoga-traditional Indian medicine) for lessons in management of food consumption & for taxation.

   Need for governance: This effort has also brought out the business behavior of tickling food consumption in individuals. Markets mechanisms reward the business behavior tickling food consumption as higher sales translates into higher profits. Governments in developed countries have set up a team to nudge people's behavior for improving health especially in the area of obesity and non-communicable diseases. The business behavior of tickling food consumption generates or increases the need for governance efforts like behavior change interventions, and regulating tickling behavior will reduce the burden of governance.

   Global framework: The Governments around the world have proposed to tax various food products to stop obesity, diabetes & other non-communicable diseases (NCDs), and they include soda tax, candy tax, sugar tax, high salt and high sugar tax, junk food tax, pasty tax, etc. Even after taxing food products there is still discussion on food supplied in large quantities, and on promotions to children in the form of gifts and toys. There is a need for comprehensive global framework for health related food taxation and it is addressed by framework below. The Global framework for health related food taxation given in Annexure 1 will be single basic resource for Overeating behaviour / tax based financing for health / behavioural insight efforts.

Other Questions:

- How does it affect developing countries?

  The idea of taxing food started in 1942 with A.J. Carlson (USA) while the whole idea was summarized by Professor Jeff Strnad (USA) in the concept note "Conceptualizing fat tax – The role of food taxes in developed economies". Many developed country practices are adopted by developing countries like India including food taxation. As the concept note on food taxes itself restricts to developed economies, there is a need to reconceptualize the idea for developing countries and for the whole world.

  The current tax practices are not in agreement of the civilizational practices of the East. Some of the food taxes levied were ineffective for various reasons. According to reliable sources 51% of the Indian population produce their own food. As a result we need to come out with different approach to understand and cover people who are out of any influence of market mechanisms.

  <u>Problem of financial inclusion & Japanese response</u>

  When a person is outside the monetary system say a lifestyle of hunter and gatherer/ agriculturist he gets the necessary food with the corresponding physical activity.

  People working within the monetary system experience a mismatch. So we need the financial structures that will connect the personal and global/community values to realize the Sustainable Development Goals.

  The parties involved here are Citizen, Government, financial system (Development banking, banking, insurance & others) and Development institutions (UN, WHO and others).

  In the developed countries, citizen movements claim for remedy through Human rights approach. In case of Non communicable diseases, health cannot be claimed comprehensively through the concept of human rights. For the purpose of prevention of non communicable diseases like obesity, diabetes etc every individual has to extend a Human Cooperation of doing physical activity to burn fat or to stay fit. Health can be earned by the concerned individual through deliberate efforts. Therefore both Human rights and Human cooperation are required for a sustainable banking and business. UNHuman rights commission has brought out a document on business and human rights as a framework for action. Similarly there is a need for a framework on Human Co-operation. In this framework we will bring out the nodal points where human beings extend cooperation with others. For example, Japan has a Metabo Law. Under this law an individual will not get any rewards for physical activity. The employer or the local government will be penalized if a person is overweight/fat. Generally a person extends human cooperation for a salary and the government imposed an additional cooperation requirement of maintaining healthy weight. Similarly, Banking & Business can insist on the requirement of daily physical activity from all the parties claiming Charity donations/CSR donations

- Are problems with the current principles of international taxation (residence and source bases; arm's length pricing…) becoming harder to deal with?

  Yes. There is no mechanism to account for negative value creation in the developing countries. Please refer to the Global problem given above.

- In your view, is the allocation of taxing rights and profit attribution to countries problematic?

  Yes. There is a need for a regulatory framework will help countries to effectively match the tax revenue from food companies against the social costs of the concerned businesses.

2. Assuming that the world continues with broadly the current international tax architecture, what does the future of corporate tax look like? For example:
   - How effectively can future tax policy changes be implemented into the existing international architecture?

     Each country has to match the social/environmental cost of the Multinational food companies at country level. Sustainable taxation and health financing would be impossible if the taxation of Multinational companies is done at a global level.

   - Will tax competition intensify or moderate?

     Moderate

3. Several proposals include elements of destination-based taxation (i.e. allocating tax base, perhaps in part, to the place of the final sale)? What pros and cons do you see in this, both in principle and in practice? Do you see the current system as already moving towards destination-based principles (e.g. interim digital taxation measures)?

   In case of HRFT the taxation would be on the basis of the Place where the cost of negative value creation is incurred.

4. Please feel free to raise any other issues that you think the IMF paper should address.
   - The Platform for Collaboration on tax / World Bank / W.H.O should take cognizance G20 declaration on Obesity, Health financing and Traditional medicine released on October 4, 2018 , and 2018 UN resolution.

     The G20 declaration

     The G20 declaration can be accessed at
     https://www.g20.org/sites/default/files/documentos_producidos/health_-_declaration_0.pdf

     Paragraph 20 under the Heading : Malnutrition: Childhood Overweight and Obesity states the following.
     "Countries may wish to integrate, where appropriate, scientifically proven traditional and complementary medicine, assuring the safety, quality and effectiveness of health services."
     UN resolution on Traditional Medicine
     Please find link to UN General assembly resolution which also speaks about best practices & traditional medicines for informed action.

     The 2018 Political declaration on NCDs on the WHO website.
     http://www.un.org/en/ga/search/view_doc.asp?symbol=A/RES/73/2

     the Paragraph 26 of the resolution
     Para 26. Share information with global and regional partners on experiences, including successes and challenges related to the implementation of national policies and programmes to prevent and control non-communicable diseases and promote health, in order to further strengthen the global knowledge and expand the evidence base on best practices and lessons learned, including on traditional medicines, to promote informed action;

   - The Tax & financial system architecture should be sensitive to the benefits of soft power and also of the family institution in developing countries. We need to recognize the fact that a family member cooks food for the well-being of the family while a business cooks food for the profit motive. This change in role of food preparation has huge implication on the health of the family and the society. In the process of food preparation the businesses resort to food design/formulation to tickle food consumption in humans. In the long run inducing food consumption through ajinomoto, saccharine, thickeners, flavor enhancers, glazing agents, coloring agents, quantity discounts, price offers etc result in overeating that causes obesity and other non communicable diseases.

- We understand the importance of UK/USA food business for the society where around 50% Child births take place outside of the marriage. Children & young adolescent have very little ability to distinguish between food consumption for hunger and consumption for the sake of consumption experience. An attachment to consumption experience is called addiction. Considering the wellbeing of the Children & young people, the relationship between food business and children should be well regulated to prevent food related health harm.

Annexure 1

The Global framework for health related food taxation – by Raghavendra Guru Srinivasan

Abstract: Overeating leads to obesity, and this work brings out the fundamental framework of overeating, the effects of food design/formulation, and the dynamics of a best practice. The United Nation's approval of Yoga (Indian medicine) is an opportunity to analyse the dynamics of the practice that keeps an individual lean & healthy which can be incorporated in the modern healthcare systems. In this direction, overeating & reduction in consumption are analysed for basic understanding, and, if necessary, for constructing appropriate regulation for food. A regulatory framework will help countries to effectively match the tax revenue from food companies against the social costs of the concerned businesses.

Background: In addition to hunger & thirst, food is also consumed for the sake of consumption experience. Food companies generally source agricultural produce and process (product designing/formulation) it into food products. The food designing generally creates new consumption experience(s) and there is overeating if consumption is due to desire for consumption experience. The consumption experiences are sensations, chewing experience, full stomach bliss etc.

The global Issue: Overeating is a global issue that leads to obesity or other non-communicable diseases, and according to the Institute for health metrics and evaluation, in 2010, diet risk was the top health risk in the world. Economic growth has improved the purchasing power of families and the role of food preparation has been shifting from families to businesses. There is change of focus with the shift in food preparation to business as higher consumption translates into higher profits.

Nationally, there are two options, one companies can voluntarily recognise the problem and reformulate the products. The second option is to tax products to discourage the consumption. Food businesses have managed to avoid such measures as it may affect their performance.

a. Campbell Soups voluntarily reduced the salt content in their soups. After the reformulation, the sales dropped and as a result the company decided to break its commitment. This is a classic example of the role of food design in increasing/decreasing food consumption.
b. Further reversal of food taxes due to industry lobby is common in United States even before the obesity epidemic. There are more than 10 instances of reversal of food taxation in United States[1]. For example, in 1997, Coca cola signed a contract with Louisiana government to build a bottling plant worth $50 million and in return managed to get food taxes repealed. On the other hand, in the case of portion cap rule (large soda cup ban) in New York, the court repealed the provisions on the ground that the city council exceeded its regulatory authority.

Internationally, the multinational food companies that cause health problems accumulate profits elsewhere while the local governments have to pick up the costs of public health. The above problem is similar to base Erosion and profit shifting where it costs the country in terms of healthcare expenses without adequate matching revenue. The deterioration in human capital due to health conditions also results in low productivity.

Second, governments around the world have proposed to tax various food products they include soda tax, sugar tax, high salt and high sugar tax, junk food tax, pastry tax, etc. Even after taxing food products there is still discussion on food supplied in large quantities, and promotions to children in the form of gifts and toys. There is a need for comprehensive global framework for food taxation.

Globally, the role of food design inducing excessive consumption is to be analysed for taxation. The problem is becoming complex as the food companies have positioned themselves as part of solution by fortifying their products with vitamins. We are in search of an authority like G7 to effectively manage this global issue.

A best practice: Mechanism of reduction in food consumption

1. Yoga reduces stress and reduces the chances of any stress induced food consumption.
2. Research evidence indicates that an Individual is in trance like state in binge eating[2]. In such case bringing consumer out of trance like state by creating self-awareness through yoga practice could be an appropriate option.
3. Theoretical frameworks of yoga practitioners reveal that there are two simple rules of thumb among yoga practitioners that lead to good habit formation. (a) People are encouraged to eat food up to half stomach and drink water for quarter stomach. Then the fourth quarter is left empty for air[3] or (b) intense practitioners of yoga eat only once a day while moderate practitioners eat twice a day. Theoretical frameworks of yoga practitioners also states that consuming food 3 times can cause disease conditions and that four or more times a day may reduce the lifespan of an individual[4].

Understanding consumption experience: In food consumption the food interacts with the sensory organs & body and creates a consumption experience which may or may not be liked by an individual. The sensory consumption experiences that are experienced by Tongue, Nose, Ears, Eyes, Skin are grouped as Taste, Smell, Sound, Visual attraction and Temperature respectively.
In addition to the sensory consumption experience there are experiences of the body. For example

1. Full Stomach bliss experienced after the consumption of food in big portions.
2. Fizzy experience of sodas.
3. Special experience of the products like Menthol, Monosodium Glutamate and others

Further, Food choice may also be due to influences over the mind of a particular person.

a. Purchase of food products due to price offers which may lead to excessive consumption.
b. Traditional practice of not wasting any food on the plate. Excessive consumption is possible if the food served generally exceeds the requirement.
c. Loyalty points offered by big retailers may influence a decision.
d. In case of sick people, Consumption of particular range of food items as prescribed by dietician.

In sum, the consumption experiences can be grouped under the head of Senses, Mind and Body. One of the stages of Yoga practice is the called pratyahara and in this stage the practitioner is believed to have gained mastery over the senses[5] and have reasonable control over mind. Food consumption normally comes down as one advances in yoga practice.

Closing the gaps in governance with fat and tickle tax: The fat & tickle tax idea introduced looks at the mechanisms through which product design/formulation can lead to unhealthy eating behaviours/patterns of consumption/preferences for unhealthy foods. This is important in understanding how/why we would expect food policies to work. A sample of applicability of fat & tickle tax is given below.

Particulars	Tickling factor	Tickle tax	Fat tax
High salt in ready to make soups	salty taste	Yes	
Salted Crisps, Salted biscuits Roasted & salted nuts	Munching experience, salty taste	Yes	
Salted & Flavoured Crisps	Munching experience, Flavours, Salt additive	Yes	
Ajinomoto	Special additive effect	Yes	
Soft drinks	Fizzy experience, unique product formula, sugary taste, chilled servings and caffeine	Yes	Yes
Ice cream	Frozen servings, sugary taste and colouring	Yes	Yes
Chocolates	Sweet taste, colour, chewing experience	Yes	Yes
Big portions of food & drinks	Desire for Full stomach bliss	Yes	Yes
Quantity discount	Desire for Full stomach bliss / Influencing mind in decision making	Yes	Possible
Price offers	Influencing mind in decision making	Yes	Possible

Table source: http://ssrn.com/abstract=2010984

- Thus tickle tax could be multidimensional. Just as the manufacturers' approach is multi-dimensional. Tax rates would be based on each tickling factor which would mean that higher the tickling higher would be the taxation. Tax rates for the tickling factor may be determined based on effect of the tickling factor.

Conclusion: Big food companies engaged in food design could be held accountable for the social costs of their operations. Taxes will discourage business behaviour of tickling food consumption. Funds raised can fund both disease prevention and the cure for conditions arising out of overeating.

Reference

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3. Verse (Sloka) 58 of the book Hatha yogapradipika of Svatmarama with commentary by Brahmananda.

4. Verse 9 of the tamil book Neethi Venba.
5. Page 5 & 171 of the book – Light on yogasutras of Patanjali by B.K.S.Iyengar.

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Consultation on IMF Analysis of International Corporate Taxation
Oxfam's Comments
December 10, 2018

The international tax landscape has seen a multitude of reforms over the past five years. But despite a proliferation of initiatives, the reforms have been unable to transform a decades-old international tax system and the current governance. Oxfam calls for a complete overhaul of the international corporate tax system along the following principles:

- Fit for the reality of the current economic system, more integrated, globalized and digitalized: the international tax system has to be redisigned to respond to the reality of business in the 21st century and capture new forms of value creation.
- Global equity: All companies, from every sector, have to pay their fair share of taxes, on an agreed common global minimum level. Profits have to be allocated based on their global activity and a combination of factors that recognizes their level of development and contribution. Countries cannot be put at competing one each other: the global race to the bottom on corporate tax must end.
- Sufficiency: The tax base of developing countries must be protected and enhanced in order to meet the funding gaps for the Sustainable Development Goals and fight inequality. Large companies have to pay their fair share, in every country where they are really operating.
- Ease of administration and compliance: International taxation needs to be simplified to work for all countries. Opportunities for tax avoidance and tax evasion must be minimized.
- Transparency: Financial secrecy by who are the ultimate owners and where large corporates opérate and how much they contribute must end to restore citizens' confidence in the social contract and integrity of the tax system.
- Global governance: Multilateralism principles in global tax reforms must be protected. Developing countries must be included on an equal footing in the decision-making about new international corporate taxation norms.

For Oxfam the best policies in light of these principles are formulary apportionment combined with a minimum global effective tax rate, at a level that it represents a fair and sufficient contribution from corporates to build sustainable development.

1. How do you view the current state of the international corporate taxation system?

The current international corporate tax system rests on a fundamentally flawed principle: the arms-length principle and the separate entity principle. The reason why multinational companies exist as integrated entities, instead of outsourcing activities to unrelated contractors, is that integration creates value. Under the arms-length principle, that value is treated as return to intangible assets or excess profit and easily finds its way to tax havens, while actual business activities are deemed to earn only a routine profit. As a result it is estimated that as much as 40% of multinational corporations' profits are shifted to tax havens.[1]

A second fundamental problem is that governments fail to cooperate to tax mobile capital, and instead compete in a desperate race to the bottom to attract it. The winners end up being

[1] https://gabriel-zucman.eu/files/TWZ2018.pdf

multinational corporations and their wealthy shareholders, while workers and consumers must pick up the tab.

• What do you see as the main successes or shortcomings of the OECD Base Erosion and Profit Shifting (BEPS) project?

The BEPS project was necessary, but not sufficient. Oxfam recognizes the progress made under the BEPS project to address some of the loopholes in the current international corporate taxation system, but much more needs to be done.

The most useful outcome of the BEPS process where the new standard on country-by-country reporting (although it could have been stronger, and the information should be made public).

The biggest shortcomings of the BEPS project were its inadequate inclusion of developing countries, its preservation of the arms-length principle as the basis of international corporate taxation, its failure to revisit the distribution of taxing rights, its lack of a separate action on extractive industries, and its failure to address tax competition and preventing the race to the bottom in corporate taxation.

See for more details: https://www.oxfam.org/en/research/still-broken-governments-must-do-more-fix-international-corporate-tax-system

• How does it affect developing countries?

Developing countries remain still excluded in having an equal voice in debates about the allocation of tax revenues, inescapably resulting in losses of revenue and calling into question the legitimacy of such reforms. The BEPS project was designed by the OECD on behalf of its members under a G20 mandate. Now that the BEPS project is at its implementation stage, many developing countries have signed up to join BEPS Inclusive Framework group with a commitment to implement the four minimum standards. They have however not been able to influence the original agenda, actions and the remaining challenges.

It is important that the consensus to address the challenges of digital taxation and a BEPS 2 plan in preparation will involve all Inclusive Framework member countries. But their capacity to be a challenging and recognized voice in such debate remains to be seen. Also, many countries, most of them low income countries, are not yet part of the Inclusive Framework and are de facto not included in the debate.

Developing countries also face hurdles to benefit from all the BEPS outcomes. For example, concerns about confidentiality and lack of a true multilateral approach limit their access to country-by-country reports. The same is true for the exchange of information of tax rulings and individuals' financial assets.

• What are your views on recent tax reforms in the US and elsewhere?

In the absence of an effective and legitimate multilateral space to agree new international tax rules, many countries are pursuing unilateral measures, undermining coordinated efforts to address significant problems with corporate tax rules. Clear examples are the US tax reform, EU initiatives on digital taxation and the EU list of non-cooperative jurisdictions.

In our views, such unilateral measures are a recognition that BEPS alone has not proven to be sufficient to address the failure of the international tax system. The EU blacklisting process recognizes the massive use of harmful tax practices, leading to a wave of crucial reforms in countries well known for their aggressive tax behavior. However, the EU is now imposing its own reforms and vision to third countries while big tax havens remain untouched inside the EU. The US instead has chosen to adopt a reform that only strives to protect the US corporate tax base at the expense of the rest of the world.

• Are problems with the current principles of international taxation (residence and source bases; arm's length pricing…) becoming harder to deal with?

The current principles of international taxation, left intact by the BEPS project, are extremely outdated. Two major changes have largely contributed in making our tax system obsolete. The role of multinationals and intra-group transactions has increased significantly. Secondly, our economy is shifting from tangible to intangible assets. The policy response to these changes has always been transfer pricing. Although transfer pricing guidelines have increased drastically, they have only become more complicated to respect for both companies and administrations while the problems are far from being solved.

The digital economy further strains current principles of international taxation. Not only it blurs the distinction between source and residence, but it also puts into question the distinction between production and consumption. Both of these distinctions are central to the value theory underpinning the arms-length principle. A clear sign of the urgency for reform is the lack of consensus on Action 1 of BEPS action plan, "Addressing the challenges of digital taxation", which has led a number of countries to take unilateral action.

• In your view, is the allocation of taxing rights and profit attribution to countries problematic?

The arm's length standard remains problematic due to its intrinsic flaw, which is the fictitious comparison between intra-group transactions within multinational economic groups and *de facto* uncontrolled transactions between unrelated parties. The treatment of hard to value intangibles is another major issue, as many businesses have most of their value invested in such unique assets. The minor adjustments promoted by the BEPS project, while well intentioned, have not been able to remedy this situation. A broader fundamental reform of the international tax system is required and should address this issue.

Until now reforms have focused on expanding the transfer pricing system, implementing more stringent tax avoidance rules and base broadening by closing some corporate tax loopholes. Due to this narrow-minded focus countries have moved to an accelerated race to the bottom in corporate tax rates and are implementing mainstreamed harmful tax practices like patent boxes Consequently, BEPS has resulted in an acceleration of the race to the bottom in corporate taxation.[2]

2. **Assuming that the world continues with broadly the current international tax architecture, what does the future of corporate tax look like?**

   For example:

[2] https://www.oxfam.org/en/research/tax-battles-dangerous-global-race-bottom-corporate-tax

• How will digitalization and the growing importance of intangibles and “user participation” (e.g., through search engines or social media) affect the system in terms of fairness, efficiency and implementation?
• How effectively can future tax policy changes be implemented into the existing international architecture?
• Will tax competition intensify or moderate?

Within the current international tax framework, amongst others, following reforms should at least be considered:
(1) tax treaties would need to be revised in order to favor source versus residency countries;
(2) permanent establishment rules would need to be simplified and expanded in order to include digital activities;
(3) more focus should be given to measures addressing developing countries’ concerns like withholding taxes;
(4) anti-tax avoidance measures should be harmonized like CFC rules for capital exporting countries and deductibility of payment rules for capital importing countries, and
(5) regional cooperation would be needed to address harmful tax incentives that endanger a proper domestic resource mobilization. The OECD Forum on Harmful Tax Practices and the EU Code of Conduct are too northern focused and do not take the reality of developing countries into account.

But continuing with the current international tax system will mean that the global race to the bottom will intensify. Governments will lower corporate tax rates and create more tax incentives, which will depress corporate tax revenues. The negative impacts will be particularly severe for developing countries, which rely on corporate taxation for a greater proportion of government revenues. The tax burden will further shift from large corporations and wealthy individuals towards workers and consumers. The most disadvantaged in society, especially women and girls, will be forced to bear the triple burden of increased consumption taxes, decreased public services, and increased unpaid care work.

3. **Can unitary/formulary methods help address weaknesses of the current architecture? If a full shift to formulary apportionment is not possible, what is your view of using some form of residual profit split in cases where arm’s length pricing doesn’t work well or make sense?**

Yes, a unitary system and formulary apportionment method would end most current practices of corporate tax avoidance. Such an approach would also benefit from simultaneous agreements on global or regional minimum effective corporate tax rates to limit corporate tax competition.

Abuse of transfer pricing would be mostly prevented due to the consolidation of all subsidiary accounts from a multinational corporation. At the same time, a formula that may take sales, assets and employment into account could ensure that the allocation of taxing rights and revenues reflect real economic activity.

It is critical that the formula does not decrease the tax base of developing countries. An essential element of that should be to carve out extractive industries, which are subject to royalties and other taxes anyway. The value of natural resources should be taxed by the countries where they are extracted. Beyond extractive industries, we can only speculate about what the right formula might be. That underlines the importance of publishing country-by-country reports to allow for an evidence-based public debate.[3]

Nevertheless, unitary/formulary methods require a high level of political coordination and would face important challenges to be implemented on a worldwide basis. It should be pursued as a long-term goal, with achievable intermediary steps in the short and mid-term leading to that objective. Applying the profit-split method for transactions without clear arms-length transfer prices is one such intermediary step. Another is introducing a formula-based alternative minimum tax (see ICRICT report).[4] Yet another is the adoption of formulary apportionment at regional level, with the CCCTB proposal in the European Union being the clearest example of possible implementation in the near future.

4. **Several proposals include elements of destination-based taxation (i.e. allocating tax base, perhaps in part, to the place of the final sale)? What pros and cons do you see in this, both in principle and in practice? Do you see the current system as already moving towards destination-based principles (e.g. interim digital taxation measures)?**

The insertion of destination-based taxation through sales location in a broader allocation formula (that may also contain other objective elements like potentially assets, payroll or number of employees for instance) represents a comprehensive interpretation of the total economic activity. While location of sales is part of the formula under consideration at the CCCTB EU proposal, this element has also been widely utilized in the allocation of domestic taxing rights among the different states in the United States and Canada. Discussions around which elements to consider into an allocation formula (as well as the specific weight given to each element) should be the subject of international negotiations where all developing countries are represented on an equal footing.

Before agreeing on what would be a more suitable approach for developing countries, the IMF and other international institutions should explore the economic impact for developing countries. While a formula based on sales might profit both developed and developing countries, the advantage will largely be in the direction of large economies. It would therefore need to be weighted and factored with other elements like employment levels than can initially better more representative of their business model.

5. **Should tax bases be changed to target only “economic rents”— “excess profits”— leaving the taxation of “normal” returns to the shareholder level (or not taxing them at all)?**

For example, this could entail using a cash-flow tax or Allowance for Corporate Equity or Capital system that allows immediate deduction at the corporate level of all investment costs, or allows an annual deduction for a standard return to invested equity as if it were debt.

Given the need for more government revenue, and funding gaps in developing countries to achieve SDGs, it would not be wise not to tax normal returns on capital. That would transfer the

[3] https://unctad.org/en/PublicationChapters/diae2018d4a5.pdf
[4] https://static1.squarespace.com/static/5a0c602bf43b5594845abb81/t/5a78e6909140b73efc08eab6/1517872798080/ICRICT+Unitary+Taxation+Eng+Feb2018.pdf

tax burden onto labor. Studies have shown that taxation of capital is not more harmful for economic growth than taxation of labor.

Transferring the taxation of capital from corporations to the individuals that own them is not a solution as a large share of corporate profits is not taxed at the shareholder level thanks to tax-exempt pension plans and endowments.

6. What do you think of proposals (or reforms such as the recently enacted US "GILTI" provision) to impose some form of minimum corporate income tax?

GILTI is a vote of no-confidence by the United States towards the current transfer pricing system in which intangible value can be easily manipulated by multinationals to shift profits. It is a good idea to impose a minimum tax on the worldwide profits of corporations, but that tax rate should not be lower than the domestic tax rate as it encourages not only profit shifting to tax havens, especially in the absence of strong foreign-controlled corporation rules, but also offshoring of actual production.

Governments need to agree at regional and global level on a minimum effective corporate tax rate. As a result of the corporate tax race to the bottom, effective corporate tax rates have declined significantly over the past few decades. If we are to stop this trend, regional or global minimum effective tax rates are essential. However, this minimum rate should be based on the financing needs of governments to fight extreme inequality. The minimum rates imposed under GILTI are far below the level that is needed.

But the risk therefore is that GILTI becomes the standard and impose a minimum level of 13,1% as global minimum effective tax rate while worldwide average nominal CIT rate is closer to 25%.

7. What is your view of taxes targeted specifically at digital activities of various forms?

Taxes on revenues of digital services companies are only acceptable as short-term solutions and should be sun-set to ensure they remain short term. We do understand the need for governments to take unilateral actions as large profits of some big tech companies are now untaxed while governments remain under-funded.

In a longer-term perspective, the issues around the taxation of digital activities should be solved through a broader reform of the international tax system that implements an effective taxation of multinational corporations with proper allocation of taxing rights and profit attribution.

It makes no sense to ring-fence digital activities within a group for tax purposes. At the same time, economies are increasingly digitalized overall and in the long run separate rules tailor-made for a few digital giants are not the solution. Although it is useful to include digital presence in a new and more comprehensive definition of permanent establishment, but a more fundamental move towards unitary taxation with formulary apportionment is preferred.

8. **How do you assess current arrangements for international tax cooperation or coordination? Are they adequate to address weaknesses you may see in the current international tax architecture?**

International tax cooperation remains thin and dominated by rich countries. The OECD remains an exclusive forum which is structured around the economic interests of developed countries and multinational corporations. Its mandate for current tax reform is derived from the G20 rather than a broader global constituency representative of all developing countries. This has been clearly reflected in the BEPS project, which suffers from a questionable legitimacy due to the limited room for non-OECD member states. The Inclusive Framework has so far had a very limited role, only helping to implement decisions already made. The Platform for Collaboration on Tax represents a limited progress towards global coordination on tax policy that has not fundamentally changed the way in which significant decisions on global reforms are made.

International tax reforms have a deep impact in all countries due to the nature of the globalized economy, therefore entrusting such changes to institutions that do not represent developing nations nor their impoverished citizens is evidently unfair. The efforts of developed nations to prevent the proper financing of the UN Tax Body clearly demonstrate a push against a proper international debate that takes into account all stakeholders.

The development of regional structures for tax cooperation in Africa are a positive step forward, as developing countries require strong technical assistance and knowledge exchange to achieve proper levels of domestic taxation and funding for public services. At the same time, increasing numbers of countries are undertaking unilateral tax reforms, undermining regional cooperation, let alone global consensus and consistency. Such actions enhance the risk of accelerating the race to the bottom as each country seeks to preserve its own tax base at the expense of others.

We need an intergovernmental tax body with universal representation on an equal footing. It must be adequately resourced and developing countries need technical assistance to defend their interests.

9. **Please feel free to raise any other issues that you think the IMF paper should address.**

The race to bottom on corporate tax rates and policies plays out directly and indirectly. Oxfam is concerned that developing countries are particularly affected by the global race to the bottom, and therefore support further analysis of spillovers in corporate tax in particular. Since pioneering the analysis in assessing the impacts of one country's tax policies on others, new frameworks are evolving for trying to assess spillover impacts. A framework due to be published soon uses a qualitative approach to complement analysis based on secondary data. Such analysis could be adapted by the IMF directly.[5]

[5] The Political Economy of ‘Tax Spillover’: A New Multilateral Framework” by Andrew Baker and Richard Murphy (forthcoming in Global Policy).