BEPS and International Tax Competition

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Introduction and overview

The OECD/G20 BEPS Initiative is a major change in the global approach to international tax planning by multinational corporations:

- tackles double non-taxation of cross-border investments
- specific country actions seem to be coalescing around this approach

The BEPS initiative preserves the traditional focus of international taxation on the source principle – tax income where it is earned. Questions:

- How will MNCs respond?
- How will governments respond?

Key message: Beware the Law of Unintended Consequences...

International Trends in Corporate Taxation

The last 20 years has seen a substantial rise in MNC activities in low-tax countries – and pressures on corporate tax rates in high-tax countries.

Caveats:

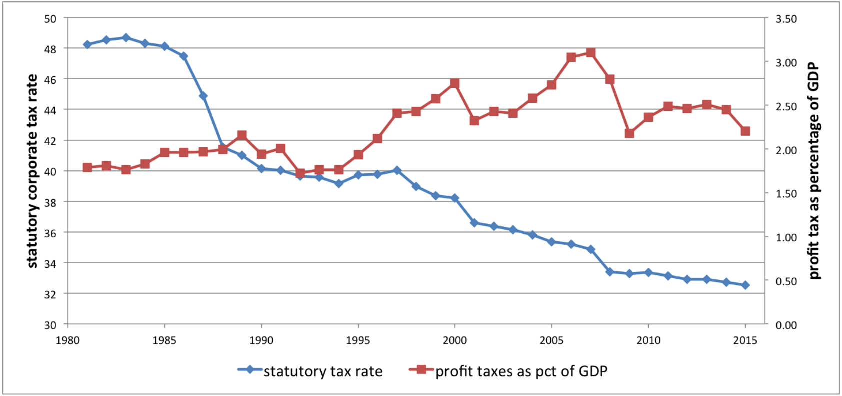
- International pressures – or domestic concerns?
- Revenues have remained stable: This does not look like a crisis

Also tax preferences aimed at mobile income of corporate groups, e.g.:

- Headquarters tax regimes, CFC rules
- Patent boxes
- Bilateral tax treaty networks and rise in treaty shopping
- Hybrid mismatch arrangements

In many cases governments have been slow to act in dealing with the issues.

Statutory and effective corporate tax rates in the OECD



Note: GDP-weighted average of OECD countries, excluding eastern Europe/Asia.
Source: OECD, Tax and Revenue Statistics.

Tax competition and corporate behaviour

There is now substantial evidence about international tax planning

- MNCs respond to taxes through both "real" business locations, and "pure avoidance" (profit shifting)

Both real and pure avoidance responses reduce revenues in high-tax countries.

But economic implications may be quite different:

- if profits can be shifted, then outsourcing pressures decline
- e.g. Mintz and Smart, 2004; Desai Foley and Hines, 2006
- do high-tax governments therefore tolerate profit shifting?

BEPS in a nutshell

The OECD/G20 BEPS initiative seeks to restrict tax avoidance opportunities in the tax codes of member and non-member states.

- focus on "double non-taxation"
- specific and substantive actions on:
  - patent boxes, debt shifting, hybrids, CFC rules, etc.
- emphasis on international coordination and transparency through:
  - information exchange, arbitration, multilateral instrument, country-by-country reporting

Overarching goal is to tighten the link between reported incomes and economic substance – and thereby reinforce the source principle as the key to international taxation

The future of BEPS

National tax rules are now changing in response to the BEPS initiative. What will these changes mean?

1. How will MNCs respond?
   - If tax is tied to economic substance, then investment must move to avoid tax
   - Potential for *greater* economic distortions
   - e.g. patent boxes and nexus – implications for location and tax treatment of R&D
   - e.g. thin-capitalization rules
2. How will governments respond?
   - Greater outsourcing pressures $\Longrightarrow$ more downward pressure on rates?
   - If existing targeted regimes are out, how will they compete instead?

Concluding remarks

BEPS and the source principle

BEPS initiative: preserve source principle, target double non-taxation.

Can the source principle be saved? Should the source principle be saved?

- Why tax mobile capital?
  - use shareholder-level residence taxation if possible
- Business taxes useful in taxing pure economic profit
  - e.g. IP and resource rents

Concluding remarks

The source principle ... and the destination principle

If governments can no longer tax mobile capital at source, then what?

- economic burden of taxes will fall on internationally immobile bases
  - workers and consumers ... and perhaps rents
- much of corporate tax burden already borne by workers
  - outsourcing pressures, reduced capital intensity and productivity $\Longrightarrow$ lower wages

Current proposals to abandon the source principle would then shift the economic burden of taxes from workers to consumers

- workers and consumers are (increasingly) not the same people
- gains for high-skill export sectors
- complex distributional implications