Statement of Barbara M. Angus
to the
House Committee on Ways and Means Subcommittee on Tax Policy
Hearing on the OECD Base Erosion and Profit Shifting Project

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Chairman Boustany, Ranking Member Neal, and distinguished members of the Subcommittee, it is an honor to appear before you today as the Subcommittee considers the implications of the OECD Base Erosion and Profit Shifting (BEPS) project. I am leader of Strategic International Tax Policy Services for Ernst & Young LLP. Earlier in my career, I had the privilege of serving as International Tax Counsel for the U.S. Treasury Department and as Business Tax Counsel for the Joint Committee on Taxation. In my role at Treasury, I was the lead U.S. representative to the OECD Committee on Fiscal Affairs, which is the OECD group responsible for work related to taxation. I am appearing today on my own behalf and not on behalf of EY or any client. The views reflected in my testimony are my own.

With the OECD's recent issuance of final reports in connection with its BEPS Action Plan, the BEPS project is entering a new phase where the focal point will be implementation of the recommendations reflected in those reports. At this stage attention must turn to the practical implications for global businesses of the changes in international tax laws and treaties that are embodied in the BEPS recommendations and that are being considered and adopted by countries around the world. Moreover, as the Ways and Means Committee continues its work toward reforming the U.S. tax system, it will be important to consider the principles and recommendations reflected in the final BEPS reports, the actions that other countries are taking in response to the BEPS recommendations, and how those actions will affect global companies that are headquartered or invested in the United States.

OECD BEPS Project, Final Reports, and Next Steps

On October 5th, the OECD issued final reports with respect to all fifteen focus areas in its BEPS Action Plan. The reports were endorsed by the G20 Finance Ministers at their meeting on October 8th and the G20 Leaders at their summit on November 15th-16th. At the core of the reports are recommendations for significant changes in countries' tax laws and treaty provisions that affect fundamental elements of the international tax framework.

The OECD's focus on BEPS began in 2012, and at the direction of the G20 BEPS became a formal project with the issuance of a preliminary report in February 2013 and the fifteen-point BEPS

Action Plan in July 2013. This occurred against the backdrop of increasingly intense criticism in Europe and elsewhere of the taxation of foreign companies with inbound investment, highly-charged rhetoric about "fair share" of taxes, and allegations of tax evasion fueling headlines in the press. The creation of an OECD project was viewed by policymakers in some G20 countries as a constructive way to approach the underlying concerns about the international tax system, through the OECD's historic role as a forum that brings countries together to consider tax matters of common interest from a combination of technical, policy and economic perspectives. However, the ambitious scope and timetable established for the project necessarily challenged the deliberative process for which the OECD is known. Rather than narrowly targeting the potential for artificial shifting of income and other erosion of countries' tax bases, the BEPS Action Plan involves virtually every aspect of the international tax infrastructure. The short deadlines included in the Action Plan meant that there was little time to engage fully with stakeholders or to reach solid agreement among countries grounded in mutual understanding of the final outcomes.

The OECD's issuance of final BEPS reports was the culmination of an expedited process of discussion drafts, comment periods and consultation sessions with respect to each of the fifteen focus areas. The global business community, including many U.S.-based businesses that actively participated in the process, submitted thousands of pages of comments on the various discussion drafts, addressing policy, economic, technical and practical aspects of the proposals for change. Business representatives participated in consultations with OECD and G20 member country officials to present their perspectives and concerns and to respond to questions and requests for further input. Other interested parties, including representatives of non-governmental organizations, also provided input during the consultation process. At the same time, the dialogue among country officials regarding the development of the recommendations continued, as the discussion drafts that were released generally were preliminary in nature and did not yet reflect agreement among the participating countries.

The final reports that were issued represent an evolution, to a greater or lesser degree, from the original drafts. Several of the final reports reflect moderation, in some cases significant, of the initial proposals for change. U.S. Treasury was an important voice in the discussions that led to these refinements. However, the process revealed how much divergence of views there is among countries in many areas. Because the OECD operates by consensus, unanimous acceptance was required for the issuance of the reports. Given the wide range of views, reaching agreement required the inclusion of options and alternative approaches in some of the reports. In other cases, the use of fairly general concepts and broad language to leave room for varied interpretations likely facilitated acceptance of the final reports.

As the OECD acknowledges, countries are sovereign and the OECD is not a rule-making body. As part of the BEPS project, OECD and G20 member countries have agreed on the recommendations reflected in the final reports. However, given the options, alternatives and broad language reflected in the reports and the complexity inherent in meshing any of these concepts with countries' existing domestic tax systems, there may be significant distance between agreement in the OECD process and ultimate adoption of new domestic tax rules. Moreover, most of the recommendations likely would require legislative changes or treaty revisions, thus necessitating the legislative or treaty ratification processes which in many countries are separate from the process for participation in the OECD. In addition, some countries may already have measures in place that they believe are consistent with one or more of the BEPS recommendations such that they would take the view that no further action would be needed in those areas.

At the same time it issued the final reports, the OECD also issued an explanatory statement that describes additional work to be done in connection with the BEPS project. There will be follow-on work in several areas, including essential work to address industry-specific issues that were not resolved in the final reports and some broader work related to transfer pricing. This work is expected to be completed in 2016 and 2017. Negotiations have just begun on the so-called multilateral instrument that is envisioned by the OECD as a mechanism for amending existing bilateral tax treaties to incorporate the BEPS recommendations that are treaty-based without a separate bilateral negotiation for each such treaty. These negotiations are expected to be completed by the end of 2016, with the instrument then open for signature by interested countries subject to each country's applicable ratification procedure. The OECD plans to develop a peer review process with respect to countries' practices in resolving disputes under treaty-based mutual agreement procedures. It is expected that this will be based on a similar process in place for peer review of countries' exchange of information practices. At the direction of the G20, the OECD also intends to develop a framework for monitoring countries' implementation of the BEPS recommendations. While the form and nature of this monitoring is not yet defined, the G20 intends that additional countries should be involved in this aspect of the BEPS work going forward. Finally, the OECD statement indicates that the OECD and G20 will continue to work together on BEPS until 2020.

Country Activity with respect to BEPS

With the OECD's issuance of the final reports, countries must now consider whether, how and when to act with respect to the various BEPS recommendations. Countries will act in their own interests and according to their own timetables. Coordination and consistency of action are likely to be limited as each country interprets the BEPS recommendations through its own lens and in the context of its own tax policies and practices.

Notwithstanding the likely absence of a coordinated approach, significant action with respect to BEPS nevertheless is expected across countries around the world. The OECD project arose out of a growing political and public focus in many countries on the taxation of foreign companies. More than 60 countries actively participated in the BEPS project, including all members of the OECD and G20 and a substantial number of developing countries. More than 90 countries are participating in the negotiation of the multilateral instrument to be used to amend existing bilateral treaties to incorporate the treaty-based BEPS recommendations. Thus, there is substantial interest by countries in the BEPS recommendations.

In the case of the BEPS recommendations with respect to transfer pricing, which represent some of the most significant changes coming out of the BEPS project, the new rules will have effect in some countries without further action by the country. The recommendations are reflected in revisions to the OECD transfer pricing guidelines, which in many countries, other than the United States, have been made a part of the countries' rules on transfer pricing through legislation or guidance. Thus, in these countries, the transfer pricing changes will become applicable as soon as the revised guidelines are finalized by the OECD.

Countries had already begun taking unilateral action to address BEPS even while the OECD process was continuing and before final recommendations had been agreed. In some cases the action taken anticipated the final BEPS recommendation and is generally consistent with it. In other cases, unilateral action that is inconsistent with the BEPS recommendations has been taken. In addition, in many countries, tax authorities have been citing BEPS concerns as justification for new administrative practices even without any change in the applicable law. In addition to individual country action, the European Union already has agreed on measures to address BEPS that all EU member countries are required to implement and several additional BEPS-related measures are under ongoing discussion in the European Union.

EY has been tracking BEPS-related developments in countries' tax law and administrative practices since the beginning of 2014. In the past two years, BEPS-related developments in more than 60 countries have been identified. Illustrations of the kinds of measures that already have been enacted, implemented or proposed include the following:

- The United Kingdom has enacted the diverted profits tax which would impose a penalty rate of tax in situations where it is considered that a permanent establishment has been avoided or profits otherwise have been artificially shifted out of the United Kingdom.

- Mexico, Poland and Spain have adopted country-by-country reporting requirements; legislation that includes country-by-country reporting is advancing through the process in Australia, China, Denmark, France, Ireland, the Netherlands, and the United Kingdom.
- The European Union has amended a directive to address certain hybrid arrangements which is to be implemented by all member states by the 2015. Brazil and Norway have proposals to address hybrids. France and Mexico have enacted anti-hybrid rules that go beyond the BEPS recommendation in this area.
- Australia, Austria, Brazil, Poland, the Slovak Republic, South Africa, and Spain have made changes to rules related to the deductibility of interest. Costa Rica, Indonesia, Japan, Korea, Lesotho, and Norway are considering changes in such rules.
- Argentina, Australia, Chile, and Germany have amended tax treaties to restrict access to benefits. Vietnam has issued administrative guidance limiting treaty benefits.
- The European Parliament is discussing requiring public reporting of information similar to the information required in the country-by-country report.

Implications for Global Businesses

Global businesses will need to monitor developments in all the countries where they operate or invest. Even in the absence of any immediate U.S. legislative action, U.S.-headquartered companies will be adversely affected by actions that are taken in the foreign countries that are part of their global footprint. The potential effects are an immediate concern because, as noted above, BEPS-related change has occurred in countries already and additional action is expected with countries' year-end tax legislation.

The OECD BEPS project and the international tax changes that are embodied in the BEPS recommendations have significant implications for all global businesses. In today's global economy, a business need not be large to have international operations. While the OECD project did not deliberately target U.S.-based companies, the recommendations could have a disproportionate impact on such businesses as they tend to be the biggest companies with the broadest global footprint. In addition, the implications of the current U.S. worldwide tax system may have the effect of exacerbating the adverse impact of the BEPS recommendations for U.S.-based companies. Moreover, some countries certainly seem to have singled out U.S.-based companies in their criticism of foreign investors and the BEPS recommendations could well be used by countries in such targeting.

Global companies face significant uncertainty in light of the BEPS recommendations, uncertainty that can be a substantial barrier to cross-border operation and investment. Change of the magnitude contemplated in the BEPS recommendations necessarily creates uncertainty.

The options and alternatives reflected in the BEPS recommendations add to the uncertainty, as does the fact that each country will make its own choices with respect to the recommendations. But the most fundamental uncertainty comes from the form of the recommendations, which generally reflect a move away from relatively clear rules and well-understood standards to less-specific rules, more subjective tests and vaguer concepts. Many of the new rules will be more difficult both for taxpayers to apply and for tax authorities to administer. Interpretations of the new rules are likely to differ – across countries, between taxpayers and tax authorities, and even over time.

One illustration of the uncertainty inherent in the new rules is the recommendations with respect to the permanent establishment standard, which is the concept used in tax treaties to establish a threshold for taxable presence in a country. The BEPS recommendation on permanent establishment replaces what are relatively bright-line standards with vaguer and more subjective tests that clearly lower the threshold but are much less clear as to exactly where the new threshold lies. A global company would have to operate without clarity as to when its activities in a foreign country would be considered to give rise to a permanent establishment such that its operations in the country would be treated like a local taxable entity subject to all of the country's domestic tax obligations. At the same time, the company's home country may see the new rules differently and may not be prepared to cede taxing jurisdiction over those operations.

Global companies face significant new compliance burdens. This includes most directly the transparency-focused BEPS recommendations: the new requirement for country-by-country reporting, the two-tier approach to transfer pricing documentation, and the mandatory disclosure regime. However, the compliance obligations do not end with the filing requirements but also will include the follow up that will be required in many countries to explain the new reporting and to put the information in proper context.

As an illustration, the new country-by-country report requires global companies to provide country-based information on various measures of income, taxes, and economic activity for all countries where they have entities or branches; this information is to be delivered to the company's home country tax authority to be shared with other countries under tax information exchange relationships or alternatively must be delivered to each country directly. The required information typically is not maintained by companies in this form for any other purpose so companies will need to create new systems and processes in order to collect the information. The report requires financial accounting information, not tax information, so it will not tie with local tax returns. The report requires information that is aggregated by country, without the elimination of intercompany transactions as is done in a financial consolidation, so it will not tie to the consolidated financial statements. Global companies will have to be prepared to respond to inquiries and provide additional information (or deal with adjustments that are proposed on the basis of the report alone) in all the countries that receive the country-by-country report. In the case of U.S.-based companies, this could be as many as a hundred or more countries, including countries where the company has relatively little local presence.

New compliance burdens also are embedded in the substantive changes reflected in the BEPS recommendations. As noted above, a global company that is considered to have a permanent establishment in a country is subject to the country's domestic tax obligations with respect to its local operations. With the BEPS recommendation lowering the permanent establishment threshold, global companies likely would have new permanent establishments, perhaps in multiple countries. This would require the establishment of new systems to create and maintain separate books and records for each set of activities that is found to be a permanent establishment. It would require the filing of income tax returns for the permanent establishment. Moreover, in many countries, the finding of a permanent establishment has consequences beyond income tax. A permanent establishment often will be required to register for and collect value added tax. Other business registration and license requirements also may be triggered.

Global companies face significant risk of misuse of core business information. The new transparency requirements would put information about a company's entire global footprint into the hands of all the countries where the company has entities or branches. For U.S.-based companies, which tend to have the broadest global footprint, the risk is particularly acute. The information required to be provided would include commercial data that is competitively sensitive. For example, the country-by-country report includes revenue and profit information from which operating margins could be estimated. The information also could be used to cause reputational damage. The information in the country-by-country report is an annual snapshot, so it might show, for example, that a company pays little or no tax in a country despite having significant income in that country without showing that this result is because of substantial net operating losses carried over from prior years. A company with that profile could be falsely branded a tax evader based on information that is improperly released to the public (in such a case the tax authority also could be falsely criticized as having failed to enforce a tax obligation). Because all countries that receive a company's country-by-country report will have its global information, a breach of confidentiality in any one country could have global effects.

Global companies face significant risk of controversy. The fundamental changes and new rules subject to varied interpretation that create uncertainty for global companies also create controversy with tax authorities. The BEPS recommendations largely are high-level policy statements. Proper implementation will require detailed and specific guidance. In many cases, appropriate transition into the new rules will be needed. In all cases, training of the tax authority personnel responsible for administering the new rules will be essential. Controversy will arise when there are gaps in any of these areas. With change happening all around the world, global companies likely will be dealing with controversy in multiple foreign countries at the same time. While some countries have advance resolution mechanisms that are intended to head off controversy, like the compliance assurance program or CAP in the United States, the demand for these mechanisms may well exceed their capacity. Many countries have no procedures for addressing issues in advance. Moreover, in some countries taxpayers have no real access to a judicial system to resolve disputes. Controversy imposes a substantial resource burden on both taxpayers and tax authorities. For taxpayers, controversy in a foreign country is more complex and requires more resources. And controversy that cannot be properly resolved results in inappropriate taxation.

Consider the BEPS recommendation on limiting access to tax treaty benefits, which includes a proposed rule under which a taxpayer would be denied treaty benefits if one of the principal purposes of the transaction was to obtain treaty benefits, unless the taxpayer can establish that the granting of such benefits would be in accordance with the object and purpose of the treaty. A global company that loans funds to a foreign affiliate will receive interest payments from the affiliate. Countries typically impose a gross-basis withholding tax on cross-border interest payments (for example, the U.S. withholding tax rate is 30%), but provide an exemption from such tax under their tax treaties. If the company is challenged under the test described above, it is not clear what proof would be required by the foreign country to establish the company's entitlement to the benefits of the treaty. In the absence of treaty benefits, the tax imposed on the gross amount of the interest payment could exceed the company's net income from the lending activity once its cost of funds is taken into account.

Global companies face significant risk of double taxation. As noted above, the recommended rules are subject to varied interpretations. Some countries may choose to go beyond the final recommendations, including resurrecting approaches that were proposed by the OECD in initial discussion drafts but were replaced with more moderate approaches in the final reports. Other countries may adopt unilateral measures. Where two or more countries do not interpret or apply the new transfer pricing rules in the same way, for example, they may assert taxing jurisdiction over the same dollar of income. One of the BEPS focus areas was the dispute resolution mechanisms in tax treaties that are intended to prevent this kind of double taxation. However, while the OECD's aim was to develop approaches for improving the effectiveness of these dispute resolution mechanisms, relatively little was accomplished in this regard. It is the view of many business stakeholders and policymakers in many countries that mandatory binding arbitration is an essential mechanism for ensuring the resolution of treaty disputes. Arbitration provisions have been included in U.S. tax treaties and are viewed as having a positive effect in terms of preventing disputes. However, some countries participating in the BEPS project have rejected such a mechanism. Where a treaty dispute cannot be properly resolved, the result for the company is unrelieved double taxation.

Even though the OECD has issued its final BEPS reports, the continuing work in the OECD on BEPS provides some opportunity to ameliorate these issues. The additional technical work that is planned should provide much needed guidance on industry-specific issues and could include further guidance on the interpretation and practical application of the BEPS recommendations more generally. The planned peer review process with respect to dispute resolution practices will allow continued attention to be focused on the need for improvements to all aspects of such practices and continued effort to expand the group of countries that are committed to mandatory binding arbitration. The framework to be developed for monitoring implementation of the BEPS recommendations should go beyond merely identifying which countries have taken which actions and should focus on encouraging and facilitating best practices for fair, effective, and transparent tax administration. The global business community should be given the opportunity to provide input to all of these workstreams and the U.S. business community, which has much at stake, should continue its participation. In order to ensure that U.S. interests are protected, it is essential that Treasury, in consultation with the tax-writing committees, continue to play an active role in all aspects of the ongoing work.

While there are significant concerns about the BEPS recommendation on country-by-country reporting, many U.S.-based companies believe it is in their interest for the U.S. to implement this requirement so that they can provide their information to the Internal Revenue Service instead of having to deal with the local reporting requirements of the many foreign countries where they have entities or branches. The IRS would share the country-by-country reports of U.S. companies with other tax authorities under the formal agreements the United States has in place for tax information exchange and subject to the U.S. rules on confidentiality of taxpayer information. If there were a problem with misuse of information in a particular country, the IRS could suspend information exchange. This approach would mean greater protection and lower administrative burdens for U.S.-based companies than the alternative of direct filing of country-by-country reports in multiple foreign countries.

Implications for U.S. Tax Reform

The United States should have a tax system that makes America an attractive place for businesses to headquarter and invest. In designing the tax system that will best support growth in U.S. jobs and the U.S. economy, it is important to consider the tax policy choices that have been made by other countries. The current U.S. corporate tax system is an outlier relative to the corporate tax systems of our major trading partners, both in terms of the corporate tax rate and the worldwide approach for taxing the foreign income of U.S.-based companies. These features adversely affect the competitiveness of companies that are headquartered in the United States and the competitiveness of U.S. investment opportunities for foreign companies.

The OECD BEPS project and countries' actions with respect to the BEPS recommendations will dramatically change the global tax landscape. The aspects of the current U.S. tax system that detract from the attractiveness of the United States as a location to headquarter and invest will become more acute. U.S.-based companies will face new pressures in the foreign countries where they operate that will exacerbate the burden of the barrier to reinvestment in the United States that is created by the current worldwide tax system. Foreign companies also will face new pressures in foreign countries that could reduce their appetite for investment in the United States. Moreover, the foreign tax credit regime that is part of the current U.S. worldwide tax system means that the cost of increased foreign taxes on U.S.-based companies will be borne in part by the U.S. fisc through reduced residual U.S. tax when foreign earnings are repatriated.

This Subcommittee and the Ways and Means Committee have long recognized the need for international tax reform in particular and comprehensive tax reform more generally. The BEPS project and the response by foreign countries should be viewed as yet another reason why tax reform must be an urgent priority.

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Thank you for the opportunity to present these perspectives. I would be happy to answer any questions the Subcommittee may have.