Statement of Catherine Schultz
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Introduction

Chairman Boustany, Ranking Member Neal and members of the Committee, thank you for inviting me to speak today about the G-20 and OECD report on the Base-Erosion and Profit Shifting (BEPS) project.

The National Foreign Trade Council (NFTC), organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Its membership covers the full spectrum of industrial, commercial, financial, and service activities. The NFTC therefore seeks to foster an environment in which U.S. companies, like their foreign counterparts, can be dynamic and effective competitors in the international business arena which will increase U.S. jobs and economic growth. To achieve this goal, businesses must be able to participate fully in business activities throughout the world, through the export of goods, services, technology, and entertainment, and through direct investment in facilities abroad. As global competition grows ever more intense, it is vital that global enterprises are not subject to excessive foreign taxes, double taxation, or other impediments to the flow of capital that can serve as barriers to full participation in the international marketplace. Foreign trade is fundamental to U.S. job creation and economic growth.

The NFTC believes the current U.S. tax law is outdated and must be modernized by enacting tax reform that reduces the U.S. corporate income tax to be more in line with our trading partners and adopts a competitive territorial tax system that does not disadvantage U.S. businesses competing in foreign markets. Competitive U.S. tax reform would address many of the concerns raised in the BEPS project.

We appreciate that the business community was invited to provide input into the BEPS project through the ability to review and submit comments on the Discussion Drafts released by the Working Parties. The BEPS project was conducted during an accelerated 2 year time frame in collaboration with the OECD, the G-20 countries who are not OECD members, and 10 developing countries. Expanding the discussion beyond OECD members in this rushed environment made the discussions and consensus building much more difficult. The Treasury Department staff should be commended for their effort to attempt to ensure the rules that were drafted were as grounded as they could be in reasonable and objective tax law. Unfortunately, this was a difficult task since the BEPS project was politically driven and we believe, appeared to be aimed more at raising revenue from U.S.-based multinational corporations (MNEs) rather than other global companies.

While the final BEPS report has been issued and endorsed by the G-20, the work is not complete. There are many issues that must still be dealt with in 2016 and the years ahead. Open items include work on implementing the tax treaty recommendations to date through the multilateral instrument, work on achieving consensus on the attribution of profits to Permanent Establishments (PEs), work on achieving a consensus on how to apply profit splits where appropriate, the implementation of rules on hard-to-value-intangibles, and the implementation of rules on the treatment of headquarter activities and other low-value adding services. There are also more difficult implementation questions raised by the final BEPS report for U.S. MNEs.

Country by Country Reporting, Master File, and Local File

One of the driving forces of the BEPS project was the perception that many country's tax auditors did not have accurate information as to the extent of a corporate taxpayer's activities within its borders. There was a belief, that companies were not transparent enough about their operations in the countries where they had facilities. To remedy this perceived problem, new transfer pricing reporting requirements were agreed to. The final BEPS guidelines call for multinational companies to comply with three new reporting requirements. The new three-tier approach for transfer pricing documentation includes a framework for the "master file" and "local file" plus a template for Country-by-Country (CbC) reporting. The Country-by-Country report is required to be filed for and contain information with respect to a company's first fiscal year beginning on or after January 1, 2016. For MNEs with a fiscal year that ends on December 31, the CbC report would be required to be filed by December 31, 2017, groups with other fiscal years would be required to file by 2018. Under the Country-by-Country reporting template, companies must report the amount of revenue, profits, income tax paid and taxes accrued, employees, stated capital and retained earnings and tangible assets annually for each tax jurisdiction in which they do business. MNEs are required to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities that each entity conducts. The CbC Reports are required to be exchanged on a confidential basis by governments through the exchange of information provisions included in tax treaties and Tax Information Exchange Agreements (TIEAs). The NFTC supports the CbC Reports being exchanged by Treasury as a way to protect taxpayer confidentiality. However, we have several concerns with the CbC report.

The Country-by-Country report is intended to provide information that is to be used only as a high-level risk assessment tool. Completing the CbC report will be cumbersome and expensive for taxpayers, particularly for taxpayers who have operations in many countries. There are many NFTC members that operate in over 100 countries. Company concerns include: Will proprietary information remain confidential? How should MNEs deal with different GAAP rules that apply for different entities in the global group? Some countries require local accountants, so there are questions regarding how and when are companies required to engage a local accountant? Business restructurings are common-- how can this be articulated in the template? Business units within a company do not always share information and in some cases they are competitors--how is this situation reconciled on the CbC reporting template? If tax authorities release taxpayer information to the public as some recommend, there is a concern about determining the correct amount due on a tax return based upon media reports rather than the tax

law. Companies understand they must share tax information on a confidential basis to the relevant tax authorities, where it can be explained in context. However, they are unwilling to be subjected to audit by media spin. It is important to note that if the US does not require country-by-country reporting subject to confidential information exchange via the U.S. treaty network, U.S. MNEs will still have to comply with the reporting requirements because each country will demand that the local subsidiaries of companies produce a Global CbC report under its local variation of the rules which will be expensive and may expose confidential information to improper disclosure. These are just some of the issues companies are facing as they begin to prepare for CbC reporting. The NFTC hopes the U.S. will continue to make the case to maintain the confidentiality of CbC reporting as the countries who participated in the BEPS project will review the implementation of the CbC Reporting in 2020.

The BEPS project also requires the filing of a Master File which provides tax administrations with high level information regarding an MNEs global business operations and transfer pricing policies, including supply chain information. This information is highly proprietary and should remain confidential. Unfortunately, unlike the Country-by-Country report, the Master File must be filed directly with other governments without the protection of the exchange of information rules. It will be difficult for companies to assure that this information will remain confidential. Indeed, companies will have to plan how to appropriately comply with the filing requirements in a manner that does not disclose their proprietary information to competitors.

The BEPS project also requires the filing of a Local Files with local tax administrations to provide information regarding material related party transactions, the amounts involved, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions. Some local files will have to be filed in the local language, although many governments are willing to accept the first version in English with some leeway on the time to file in the local language. Like the Master File, the Local File is filed directly with the local tax administration and does not have an exchange of information confidentiality protections.

Countries are already adopting these reporting requirements, and they are not all following the BEPS report guidelines. Indeed, China has already said that it will require entire value chains to be reported in all local analysis. Companies are concerned with how the information they are required to file will be used by local tax authorities. Countries are already becoming more aggressive in seeking information from taxpayers even before they have officially adopted by BEPS reporting standards. We understand that Australia intended to release all tax information for all MNEs until some if its domestic companies realized that their tax information would also be made public. The Australian Senate has pulled back on the proposed legislation and it is currently under further review.

We believe it is important for Treasury and the IRS to provide further guidance so companies can report their information to the IRS with Section 6103 protected information exchanged via the U.S. tax treaty network. Otherwise, as I have noted, other countries will be entitled to request for it without Section 6103 protections.

There are several other issues that concern our member companies with respect to the final BEPS

report

BEPS Action 7 Permanent Establishment

BEPS Action 7 recommended several changes to the longstanding definition of what constitutes a permanent establishment which subjects a business to income tax in a local country. Action 7 changes the definition of a "deemed" income tax permanent establishment (PE) to achieve in-country income tax results under applicable transfer pricing rules. This will result in more companies being subject to tax in a local jurisdiction, yet we are still waiting for the OECD work to begin to define how to measure the profits, if any attributable to these deemed PEs. Without full agreement between countries on income attribution, taxpayers have no idea how much income is subject to a "deemed PE". We are very concerned that there will not be agreement and taxpayers will be facing real risks of double or triple taxation. As these taxes imposed on deemed PEs are potentially eligible for a foreign tax credit on U.S. tax returns, this has an impact on the US fisc.

Further, we are not aware of any discussion, or even recognition, of the many potential collateral consequences of changing the PE definitions. For example, it is not clear whether the "deemed" PE will be treated as a PE for VAT purposes or customs purposes or legal business registration purposes. In the face of these uncertainties, diligent taxpayers simply trying to comply may have to create accounting systems, invoicing systems, customs processing systems, procurement and ordering systems and many other systems which are expensive and will take years to implement. We believe that the critical goal for tax administrations and taxpayers should be ensuring that the appropriate amount of tax due is reported and paid to the tax authorities without creating undue burdens or areas of unnecessary dispute. The U.S. must work with the other countries to agree that a deemed income tax PE does not create a deemed VAT PE or a deemed change in who is obligated for customs duties and importation compliance and that there be a sufficient transition period so taxpayers can actually comply.

For most countries, more revenue is raised from their VAT systems than through the income tax systems. The U.S. is the only OECD country without a VAT, and all U.S. MNEs must comply with the VAT guidelines and collect and remit VATs to the countries where they are selling or operating. By lowering the threshold for what constitutes a PE for VAT purposes, some governments are being aggressive and are insisting that companies that have agents for VAT collection and remission, also have a PE for income tax purposes. The BEPS Guidelines specifically state that an agency for VAT collection should not create a PE for direct tax purposes, but this is just one area where countries are already going outside the guidelines set out in the BEPS report to implement their own more aggressive rules to the detriment of U.S. MNEs and against the interests of the United States.

Transfer Pricing

Actions 8-10 of the BEPS report will lead to changes in the OECD Transfer Pricing Guidelines.

There were considerable changes to the transfer pricing rules that raise concern for taxpayers. The Treasury Department did an admirable job of insisting that the arm's length standard be retained for transfer pricing purposes as some countries continued to push for moving to a more formulary apportionment standard. The BEPS project guidance on applying the arm's length principle provides guidance on identifying the actual transaction undertaken, on what is meant by control of a risk, and on the circumstances in which the actual transaction undertaken may be disregarded for transfer pricing purposes. For the taxation of intangibles, the final BEPS report provides guidance on which entity or entities are entitled to share in the economic return from exploiting intangibles. The final report provides that mere legal ownership of an intangible does not confer any right to the return from its exploitation. Instead, the economic return from intangibles will accrue to the entities that perform the important value-creating functions of developing, enhancing, maintaining, protecting and exploiting the intangible, and that assume and manage the risk associated with those functions. It is often hard to determine where value is created. Although the final report confirms that database comparables are seldom appropriate for pricing intangible transactions, and provides guidance on the use of other valuation techniques that may be more applicable, there is no objective measure on how to determine value creation. If value creation is supposedly tied to function, it would be difficult to determine the final value because value and function are not always linked, and because there is no international consensus on how to allocate profits where value-creating functions occur in more than one location. Some countries are adding additional value creation requirements. China is insisting on a "value contribution method" that departs from the BEPS guidelines. Location specific advantage will be used in comparability analysis. The taxation of intangibles is one of the most controversial aspects of the BEPS report and is likely to result in more tax being paid by US MNCs to foreign jurisdictions. Countries will try to look at leading U.S. companies and try to raise more revenue through more aggressive audits of the transfer pricing of intangibles.

The implementation of the guidelines for hard-to-value-intangibles will not be completed until 2016. At the beginning of the BEPS project, there was a great deal of discussion of "special measures" where the normal transfer pricing arm's length standard would not apply. Under the hard-to-value-intangibles draft when intangibles are transferred or licensed in development or where there value is uncertain, the tax administration is entitled to use the *ex post* evidence about the financial outcomes to determine the arm's length pricing arrangements, including any contingent pricing arrangements, that would have been made between independent enterprises at the time of the transaction. These rules do not take into consideration the significant risks associated with the commercialization of any intangible. It is impossible for a company to accurately predict the outcome of research and development. What if your main competitor goes bankrupt? What if the product developed is similar to another product brought on the market with similar characteristics? We are concerned that the BEPS report includes subjective terminology relating to "satisfactory evidence" and "significant" differences between expectations and outcomes. Companies are concerned that tax authorities will use *ex post* information in any situation where reliable comparables are not available to support the pricing of any significant intangible. This will result in more tax disputes.

The implementation of the guidelines on headquarters activities and other low value-adding services will not be implemented until 2018. The purpose of these rules is to mitigate double

taxation by ensuring that expenses for headquarters and other support activities are deductible once in the appropriate jurisdiction. This work is of disproportionate importance to the United States and U.S. MNEs given the fact that a disproportionate amount of headquarters and other corporate support activities occur in the United States. Accordingly, companies are concerned that this aspect of the BEPS work will continue to be deferred or will not be implemented with as much vigor as other aspects of the project.

Dispute Resolution - Mandatory Binding Arbitration

The NFTC strongly supports the inclusion of a mandatory binding arbitration clause in the multilateral instrument currently being drafted by the BEPS project member countries. Over 20 countries have already agreed to include mandatory binding arbitration in their treaties. We are also pleased that the new U.S. Model Tax Treaty will include a mandatory binding arbitration provision. As countries become more aggressive in their application of rules under the guise of the BEPS report, we are greatly concerned that the number of disputes will significantly increase. Without the mandatory binding arbitration provision, countries would have no incentive to resolve tax cases in a timely manner. At a time when the IRS budget is constrained and the Competent Authority has more limited resources, there must be a way to resolve tax disputes between countries in an efficient manner.

Conclusion

The NFTC is concerned about the general aggressive global tax enforcement environment. The BEPS report Action 11 analyzed base erosion and estimated how much is lost worldwide to aggressive tax planning. Interestingly, this analysis was not done prior to the start of the BEPS project, but only at the very end. If it was an objective concern, and not a political project, the amount of base erosion would have been examined at the outset of the project, not at the very end of it. As countries continue their aggressive stance to collect "enough" taxes to counter base erosion, who will determine what "enough" is? If BEPS is hard to determine beyond an "I know it when I see it "standard, how will it be determined when it no longer exists? As other governments increase taxes on U.S. multinational companies, the U.S. will provide Foreign Tax Credits to those companies to offset double taxation on the same income. As the number of Foreign Tax Credits increases, we will see more base erosion--but this time, it will be the U.S. base that is being eroded.

What can Congress do to protect the U.S. fisc from being eroded further? The NFTC is strongly in favor of tax reform that lowers corporate income tax rates in line with our trading partners and moves to a competitive territorial-style tax system. Revenue that effectively is part of the U.S. tax base, is being claimed by other countries. It is not their revenue, it is ours, and modernizing the U.S. tax system will ensure that companies will have the ability to increase their investments and jobs in the U.S.

Thank you for the opportunity to present the views of the National Foreign Trade Council on this important subject. I would be happy to answer any questions.