Position Paper on the Organisation for Economic Co-Operation and Development's Project on Base Erosion and Profit Shifting

Submitted to	The United States House of Representatives Committee on Ways & Means
In relation to	Tax Policy Subcommittee Hearing: Examining the OECD Base Erosion and Profit Shifting (BEPS) Project
Date	3 December 2015
Submitted by	The Business and Industry Advisory Committee to the OECD

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BIAC has been supportive of the OECD's Base Erosion and Profit Shifting ("BEPS") project since its inception and has provided constructive and detailed input from the international business community in response to all discussion drafts. Although we value the openness of the consultation processes and acknowledge the efforts of OECD and G20 member governments and the OECD Secretariat, we are anxious that some serious business concerns have not been sufficiently considered or addressed.

At the March 2015 meeting of the BIAC Tax Committee, a substantial number of member organizations expressed concerns over the direction of certain aspects of the BEPS project, and the potential significant negative economic consequences of several Action Items, and it was agreed to set those out in a short document. This document has been updated following the release of the OECD's final reports in October 2015. We would reiterate, despite the concerns noted below, that we want the BEPS project to succeed. We will continue to approach this project – both before and after the adoption of the recommendations by the G20 – in a constructive, flexible and incremental way as we believe this is the best way of achieving that success. We call on the OECD to continue to include us in the completion of outstanding work, and the development and implementation of the G20 proposed framework for implementation.

General comments

Many of the concerns identified in this Position Paper are common across the range of Action Items. We feel they are worth repeating up front as their importance continues to grow as the follow-up and implementation work commences.

Economic impact: There is great concern that the economic consequences of the recommendations have not yet been fully considered. Countries should be undertaking realistic assessments of the tax revenues they may be due under the consensus reached, rather than assuming that implementation will bring additional tax revenues. The possibility should be understood that overly strict regulation could force economic activity out of countries. Countries should not rush to implement proposals with such aims in mind when the actual impact on their tax revenues has not been determined - this could undermine the BEPS process and bring about unintended economic implications. Although uncertainty, double-taxation, disputes and compliance burdens are a focus of business, we are also concerned about the broader economic impact, which may include, for example, the impact on the efficiency of markets, or the sustainability of certain legitimate non-tax driven commercial transactions and structures (for example, cross-border infrastructure projects or regionalisation of certain functions to improve quality and efficiency). We believe that the justified targeting

of BEPS activities must be integrated with larger economic concerns related to creating jobs and growth through cross-border trade and investment.

Complexity & Compliance: In a number of areas, the BEPS Action Plan proposes substantially new and complex rules to tackle avoidance. Given the pressures of the ambitious timeframe, there have been very few opportunities to explore how these complex proposals can be adopted and implemented on an international basis. Both tax authorities and businesses will need detailed implementing guidance to ensure that the intention of each recommendation is clear. This will be critically important in ensuring that the recommendations are uniformly adopted, whilst avoiding overlaps. The challenges that will be brought about through the interaction of different timelines and domestic implementations should not be underestimated. They could lead to double taxation and a significant compliance burden on both businesses and tax authorities and create uncertainty that will delay necessary investments. We look forward to the OECD's development of an inclusive framework to support and monitor the implementation (as proposed by the G20 Finance Ministers) to assist in maintaining international co-operation and as much consistency in timing and application as is possible. We would encourage the OECD to seek agreement from involved countries on effective dates after which new rules and guidelines will apply; even with the OECD's work on Action 14, it will be very difficult to eliminate double taxation and would be inequitable if some tax authorities seek to revisit past years with new concepts and methodologies.

Scoping: As part of the implementation framework, we believe it would be helpful to target the scope of each recommendation more narrowly to increase the chance of developing the necessary inter-governmental co-operation. At present, many proposals appear to go beyond the scope required to effectively target BEPS related activities. We strongly believe that "success" in the BEPS project would be achieved with a set of detailed, well-defined proposals that can be (and are) implemented consistently. Countries should be encouraged to avoid overly-broad implementation that could lead to a less uniform international tax regime.

Timing: As well as the timing concerns raised above in relation to the potential economic impact and the potentially disjointed international adoption of the recommendations, we also have a more general timing concern that impatient countries and tax authorities may seek to commence full implementation of recommendations where it has been agreed that further work is required. For example, critically important work remains in relation to profit attribution to permanent establishments and specific rules in relation to financial services and insurance businesses.

Reaching consensus

BIAC has strongly supported the OECD as the best organisation to deliver a successful consensus outcome under the BEPS mandate and recognises the phenomenal work that the OECD has done in brokering compromises and consensus wherever it has been possible. However, despite the OECD's claims, we are concerned that in many instances it has proved difficult (and occasionally impossible) for member governments to reach consensus. This has resulted in a lack of clarity and a degree of ambiguity. For example, whilst the OECD has not recommended solutions regarding the "digital economy", the door has been left open for countries to implement solutions unilaterally which, if implemented, could lead to double taxation.

Understanding the economic impact

It remains a matter of some regret that, owing to the political nature of the timetable, the BEPS project could not begin with a detailed economic analysis of the abuses identified in the Action Plan, including the scale and importance of "double non-taxation" and "tax competition". We are concerned that the public announcements and discourse have been optimistic in terms of the amounts of additional tax that will be collected as a result of the BEPS recommendations, due in part to the conclusions reached in Action 11, and strengthened by the impression that the expectation of additional tax receipts was in some way a pre-requisite of reaching a broad consensus. Whilst we understand the public and political pressure surrounding

the project elevated a need for consensus in agreeing that businesses should be taxed on all profits, most countries who have offered a public opinion on the matter seem to have assumed that the implementation of the proposals will increase their tax revenues substantially.

In reality, depending on which of the proposals are introduced by themselves and/or other countries, there could be many countries that do not receive additional tax revenues. There may be cases where overly strict regulation pushes economic activity out of some countries. If not dealt with by rigorous impact assessments both at international and domestic levels, we are concerned that this expectations gap could lead to countries budgeting for higher tax revenues than they will receive. The resulting pressure could end in countries opting not to implement all of the proposals uniformly, an outcome that would result in double taxation and more pressure on individual tax authorities to aggressively audit taxpayers in an attempt to collect *more* tax rather than *the right amount* of tax based on the consensus agreed. A failure of the BEPS project in such a manner is not in the interests of business, governments or the public and will significantly increase the costs of tax administration and tax compliance.

Complexity and compliance burden

The BEPS recommendations are likely to create significant implementation difficulties and greater compliance burdens, not only for Multinational Enterprises (MNEs), but also governments - this is in part due to the substantial number of recommendations, but also their complexity and the different timelines that will need to be followed to implement them (for example, the adoption of revised OECD Guidelines into domestic law, or different processes for implementing domestic recommendations). Public and considered consultation and strong commitment by countries to work together (supported by the OECD's implementation framework to be developed in 2016) are essential to avoid fragmentation.

We would encourage the OECD to seek agreement from involved countries on effective dates after which new rules and guidelines will apply; even if the OECD's work on Action 14 is successful in improving dispute resolution, it will be very difficult to eliminate double taxation and would be inequitable if some tax authorities seek to revisit past years with new concepts and methodologies.

We support the OECD's statement that VAT registrations should not create PEs, and we would encourage tax administrations to heed this and not assume that PEs exist where a company is registered for VAT (or vice versa), which would result in significant compliance burden. Other Action Items (for example, Actions 2, 3, 4, 7 and 12) are also likely to require significant additional resource to ensure compliance with new, complex and sometimes contradictory rules.

Discouragement of related party trade

Many of the BEPS Action Items apply only in an intra-group context and could significantly increase the cost of performing various functions or undertaking certain transactions inside a group of related companies. For example, the recommendations to lower the PE threshold and the complex new transfer pricing analyses that only apply to transactions between affiliates could greatly increase the compliance cost and tax liabilities associated with various intra-group activities. In some cases, taxpayers may, effectively, be forced to conduct business with third parties to mitigate excessive tax cost or uncertainty. This would reduce commercial and economic efficiencies and hamper international trade (as well as, quite possibly, lowering the wages and benefits in outsourced functions – especially in developing countries). We believe that these effects should be considered in greater detail and encourage additional guidance to be developed to provide greater certainty.

Appropriate resources for tax administrations

Tax administrations already receive significant amounts of information that they often struggle to process. We are concerned that without additional resources, tax administrations will face difficulties in effectively using additional information and in dealing with the expected increase in requests for exchange of tax

information between countries. It may actually become more difficult to identify risks, or to target abuse, to the advantage only of the most aggressive taxpayers.

We believe a greater focus on tax administration would be beneficial - for example, through fully integrating the work of the Forum on Tax Administration - and the use of targeted risk-based measures. This could include materiality thresholds and other risk-identification tools to target higher risk taxpayers/issues that represent the most substantial sums of lost tax revenues. Such approaches reduce the burden on the vast majority of compliant taxpayers, freeing up resources for more productive, value-creating activities. Cooperative compliance also has an important role to play in this area.

Multilateral implementation

The ultimate success of the BEPS project will be the multilateral implementation of specific, measurable, achievable and realistic recommendations on a timely basis. Whilst much work on implementation mechanisms is still to come throughout 2016; we encourage early discussions on approaches to enhance credibility and likely success of the project. We make the following recommendations in this regard:

- The G20 proposed engagement framework should be prepared and managed by the OECD Secretariat;
- As a first step, all countries should agree to key principles to be followed in any domestic legislation used to enact BEPS proposals. Such principles could include that:
    - the policy objective should be clearly stated;
    - the policy objective should be consistent with the BEPS recommendation, and in particular, should be limited to addressing specific abuses;
    - draft legislation should be prospective in application and be published with a minimum period for detailed stakeholder consultation; and
    - an impact assessment should be prepared to evaluate any compliance burdens created.
- We encourage the OECD to coordinate the implementation so that national measures have a reasonable degree of consistency.

BEPS Action Item-specific comments

Address the tax challenges of the digital economy (Action 1)

We greatly welcomed the original 2014 report (*Addressing the Tax Challenges of the Digital Economy*), but we consider that the final 2015 report does not go far enough by recommending only that such countries are mindful of their treaty obligations until further review in 2020. There is concern amongst BIAC members that some countries are considering withholding taxes on digital transactions, and whilst the final report recognises that this is not recommended, it neither discourages such action nor identifies the treaty obligations and implications that such taxes could breach. Such unilateral action will certainly result in double or even multiple-taxation unless there is a very clear and strong consensus as to how the profits of digital business transactions should be taxed. BIAC looks forward to participating in ongoing monitoring and evaluation characteristics of digital trade that may cause BEPS concerns.

Neutralizing the effects of hybrid mismatch arrangements (Action 2)

While we do not defend hybrid mismatches as a general policy matter, we do want to make three important points on the final report:

- It is not clear which countries intend to implement any or all of the recommendations, when they plan to do so, or how the interaction with the local legislative processes will result in differences between countries in terms of application or timing. Implementation through a combination of complex changes to domestic laws, bilateral treaty provisions and potentially a multilateral instrument increases the uncertainty on timing further. We welcome the development of an inclusive monitoring framework in early 2016 to assist international cooperation but retain concerns

in particular regarding the risk of double taxation, increased compliance burden and uncertainty that will arise from countries implementing at different times.

- Even if implemented in a coordinated manner, the complexity of the proposed rules will create substantial compliance difficulties, and will complicate the allocation of taxing rights between jurisdictions, increasing the risk of double taxation (e.g., the rules on "imported mismatches"). The accompanying expanded examples may provide clarity on some issues, but at the price of still further complexity.
- The financial services industry continues to be concerned that insufficient attention has been given to how the proposals will impact instruments deemed important by banking regulatory authorities for systemic liquidity. By relying on countries to opt not to tax such transactions at their discretion increases uncertainty and the risk of double taxation.

Strengthen CFC rules (Action 3)

The broad nature of the OECD's final CFC proposals illustrate the difficulty in reaching a consensus position on even the basic purpose of rules, with clear disagreements between governments over whether such rules should tackle profit shifting from the parent entity or foreign-to-foreign abuse. Without clear agreement over the underlying principles, the chances of delivering clear, proportionate and practical solutions were almost impossible. This was an opportunity missed to refine a useful tool, based on well-understood concepts of "active" and "passive" income in ways that could reduce dependence on subjective, fact-intensive enquiries while at the same time limiting the compliance burden and risk of double taxation. We urge the OECD to consider CFC rules further when addressing any future BEPS concerns that the monitoring and analysis highlight.

Limiting base erosion via interest deductions & other financial payments (Action 4)

The final report on Action Item 4 will have serious implications for groups' economic activity and their ability to obtain tax deductions for funding costs. The proposals have been made without a clear articulation of how they specifically target BEPS activities. The OECD's proposals are likely to restrict interest deductions for a significant number of non-aggressive taxpayers, particularly those investing in infrastructure or long term projects where it remains unclear whether they would qualify for the proposed exemptions. The lack of support for the arm's length principle in Action Item 4 also undermines legitimate commercial reasons for having intercompany debt. A group's cash position and decisions on how to deploy cash should not be limited by rules that are not based on the arm's length principle.

However, given the options previously put forward in discussion drafts, we do welcome the broadening of the corridor approach to a range between 10% and 30% of EBITDA and the relative simplicity it brings. However, this approach could have serious consequences if detailed work is not undertaken to determine appropriate ratios, taking into account the funding requirements of different industries. Where ratios are set too low, this could substantially raise the cost of capital for low-risk taxpayers undertaking commercial transactions. We are disappointed that the proposals do not recommend more strongly the elements of the proposals that would seek to limit double taxation, such as the ability to carry forward unutilised interest capacity (especially for start-ups and companies in loss-making positions) or give credit for all withholding taxes suffered.

Additionally, we note that interest is the "raw material" for financial services businesses. Although a "net interest" approach is endorsed, it is important that the outstanding questions facing the financial services industry be resolved, particularly so that proposals do not contradict the regulatory agenda.

Whilst we welcome the attention that the OECD plans to give to the group wide ratio rules, financial services and insurance industries 2016, we have serious concerns that so much work remains outstanding in this area at a time when countries are otherwise being encouraged to start implementing the rules.

Prevent treaty abuse (Action 6)

We are concerned that significant uncertainty remains as to whether treaty relief is available in ordinary commercial circumstances. This uncertainty risks undermining the usefulness of treaty networks in facilitating trade and promoting economic growth. Whilst we recognise that tax administrations require assurance that treaty benefits are only being granted in appropriate circumstances, anti-abuse rules should be applied in a proportionate and targeted manner. The existing provisions and Guidance could provide more clarity (e.g. low taxed branches with substance, calculation of head office tax rate). Broad disapplication of treaty benefits could create substantial withholding tax burdens and negatively impact cross-border trade.

The final proposed minimum treaty standards are at the very least expected to create a significant compliance burden for taxpayers (especially where both a simplified LOB and a PPT rule are adopted in certain treaties), and will potentially bring into scope legitimate structures that ought to be entitled to treaty benefits. We remain concerned that:

- Structures not involving treaty shopping may be unintentionally caught by broad rules.
- There will be increased cross-border investor uncertainty, especially for pension fund investors and sovereign wealth funds, where the potential for tax treaty abuse is low.
- Uncertainty for Collective Investment Vehicles (CIVs) will be unavoidable, and the time taken to receive repayments of tax deducted at source will impact the Net Asset Values of funds.
- Source country tax authorities may experience additional demands to process an increased volume of reclaims, placing further pressure on already resource constrained administrations.

Whilst we recognise that the OECD has further work to do regarding the commentary on LOB rules and the impact on non-CIVs and pension funds and welcome the OECD's commitment to consult on such matters, we remain concerned that the in order for this to be taken into account as a meaningful component of the multilateral instrument negotiations, this work must be completed swiftly.

Preventing the artificial avoidance of PE status (Action 7)

Whilst many of our members welcome the move away from the ambiguous language of the discussion draft that sought to establish a PE where persons “negotiated the material elements of contracts”, we are concerned that the final deliverables introduce new concepts that were not open to consultation and so retain ambiguity. Whilst we welcome the move to recommendations that a dependent agent PE is only established where a person “plays the principal role” in negotiating contracts, we urge the OECD to undertake additional consultation and provide tax authorities with additional guidance to clarify the meaning further. Similarly, the meanings of “complementary functions that are part of a cohesive business operation” in relation to fragmentation and “at the disposal of” regarding fixed places of business should be more tightly defined to ensure consistency in implementation.

It is disappointing that recommendations regarding PE thresholds have been released before the guidance that will follow on profit attribution. We are concerned that tax authorities will seek to establish the existence of PEs based on new concepts before providing business with any certainty regarding the attribution of profits to these newly defined PEs. For instance, the example of a PE being triggered by an agent who convinces customers to accept standard contracts without any authority to make deviations is very different to the previous definitions. Additionally, we would welcome the confirmation that PEs can be loss making.

It is more disappointing still that the changes required to the OECD Model Treaty, OECD Guidance and domestic/multilateral implementation thereof will undoubtedly be disjointed, and we fear that some tax authorities may seek to apply the new concepts to open periods, which will cause considerable uncertainty and double taxation to arise. We urge the OECD to consider the impact of this as part of the implementation framework being developed and wait until there is a consistent understanding of the concepts before updating the Model Treaty and Guidance.

Transfer pricing (Actions 8-10)

We have consistently acknowledged the need to update international tax rules on Transfer Pricing (TP), especially in relation to intangibles. However, aspects of BEPS project illustrate fundamental differences in opinions between countries over the Arm's Length Principle (ALP) in TP and its continued viability. We are hesitant in agreeing with the OECD that the final report's recommendations have been finalised without a departure from the ALP.

We welcome the confirmation that where clear contractual arrangements exist that are supported by economic reality, then recharacterisation is not generally required. However, we are concerned about the complexity of the process, the level of detail required, and the consequences it will entail in the practical application. For example, the modifications do not clearly address the relevance of or extent to which (control and) performance of DEMPE functions and risk should contribute to calculating price under the ALP . These are not generally factors that are taken into account by unrelated parties. We welcome the reiteration that the most appropriate TP methodology should be used, and the OECD's commitment to developing guidance on profit split methodologies. However, we note that with this work expected to remain incomplete until 2017, a significant period of uncertainty remains, which will cause considerable uncertainty and double taxation to arise. We urge the OECD to consider the impact of this as part of the implementation framework being developed and prioritise these areas accordingly.

We welcome the confirmation that tax authorities should only be permitted to consider *ex post* outcomes as presumptive evidence about the appropriateness of the *ex ante* pricing arrangements where taxpayers cannot demonstrate that the uncertainty was appropriately measured in the pricing methodology adopted. However, the distinction between foreseen and unforeseen is subjective and very difficult to make. Additionally, there are many areas of the report that appear ambiguous which will allow countries to take divergent positions. We believe that there remains a significant risk of divergence in interpretation and extent of these approaches, and ultimately of tax authorities using hindsight to recharacterise non-abusive transactions.

Whilst we would welcome the simplicity that the elective regime for Cost Contribution Arrangements (CCAs) could provide, without a commitment from a significant number of countries to implement such a regime it remains the case that businesses will still face a significant compliance burden in satisfying the countries that do not implement it. If a significant number of countries could be encouraged to implement the elective regime at least in part (e.g. service CCAs) this would address these concerns in some cases.

Financial services institutions face regulatory pressures that differentiate them from groups operating in other sectors. The OECD's 2010 report on the attribution of profits to PEs remains relevant for the taxation of this sector. BIAC cautions against special measures or general principles that move away from this well-established approach.

BEPS Data (Action 11)

Whilst the business community generally agrees that insufficient data is available and that such data would be useful (and are thus supportive of the initiative), there has not been significant engagement with business in this area. We would welcome the opportunity to assist the OECD in its further work on identifying and analysing data on BEPS.

Re-examine transfer pricing documentation (Action 13)

BIAC fully supports the recognition under Action 13 of the importance of protecting the confidentiality of commercially sensitive information. This protection should apply across all three pillars of TP documentation. We consider it would be a useful addition (perhaps under the framework to be developed in 2016) if peer review mechanisms could be developed to monitor jurisdictions' adherence to appropriate confidentiality standards, and to ensure that the OECD's proposals are uniformly adopted.

The Action 13 recommendations will create substantial burdens for business, and effective compliance will require much preparation. For example, there remains ambiguity around areas such as the practicalities of reporting Master Files on a business line basis whilst maintaining a global overview, and many countries are already seeking to implement the country-by-country reporting elements recommendations before the guidance and XML schema are even released. Without further guidance, much of the necessary preparation is impossible. Such implementing guidance should, where possible, leverage data reported under similar regimes (for example the EU's CRD IV for banking organisations) to streamline the compliance burden for as many taxpayers as possible. Only uniform TP documentation rules across countries will limit the resulting increase in compliance costs for companies, and we urge the OECD to encourage consistency in this area.

Make dispute resolution mechanisms more effective (Action 14)

We congratulate the OECD on the significant steps forward that have been taken in its work on Mutual Agreement Procedure (MAP). The recommended minimum standards on MAP and peer reviews is a welcomed development in the final report. We welcome the OECD FTA's MAP Forum as the best place for peer reviews to be undertaken, and encourage the OECD and governments to commit appropriate resource to ensure that the minimum standards can be upheld. The full picture of the success of the minimum standards on MAP (and the success of the BEPS Project as a whole) cannot be judged with reference only to tax authorities' data; we would welcome the opportunity to also be consulted as part of the OECD's monitoring framework.

We also congratulate the OECD on securing the commitment of 20 countries to binding arbitration and we urge the OECD to allocate necessary resource to ensuring this area is successful. We hope that this will demonstrate to non-participating countries the benefits of such a process to its participants and hope that this will become an international standard that other countries are compelled to join.

Multilateral Instrument (Action 15)

We congratulate the OECD on securing the commitment of c.90 countries to participate in the development of this ambitious project in 2016. We recognise the benefits that could arise from a significant number of countries signing up to the instrument in order to swiftly and uniformly implement the OECD's proposals.

Whilst the detailed timeline and consultation requirements have not been made public; we hope that the OECD will seek to consult widely and take up BIAC's offer of support in its work on development of the Multilateral Instrument.

Statement of

Andrew F. Quinlan
President
Center for Freedom and Prosperity

House Committee on Ways & Means
Subcommittee on Tax Policy
Hearing on The OECD Base Erosion and Profit Shifting (BEPS) Project

December 1, 2015

Chairman Boustany, Ranking Member Neal, and Members of the Subcommittee on Tax Policy, thank you for the opportunity to submit written testimony on the OECD's project on Base Erosion and Profit Shifting (BEPS).

My name is Andrew Quinlan. I am the president of the Center for Freedom & Prosperity (CF&P). The primary mission of the Center for Freedom & Prosperity is to defend tax competition as an important principle that helps ensure a prosperous global economy.

The BEPS project poses a direct threat to tax competition and American business.

First and foremost, it is necessary to understand that the OECD does not have American interests at heart, nor even the welfare of the global economy. Rather, it is an unaccountable bureaucracy that serves the narrow interests of finance ministers and tax collectors from its rich-nation members.

The OECD has a long documented history of advocating policies against the interests of American taxpayers and businesses, and of abusing its reputation to strong-arm jurisdictions into adopting self-destructive tax policies.

The United States must not buckle under pressure to do so in the case of BEPS.

The project on Base Erosion and Profit Shifting has been pushed under a dishonest premise. Despite a relatively small and temporary dip in recent years thanks to the recession, corporate tax revenues as a share of global GDP have trended steadily and decisively upward over the last few decades. The contrary but popular idea of a corporate tax dodging problem is a myth designed to draw attention away from irresponsible budgets and profligate government spending.

In order to avoid scrutiny of the project, BEPS preceded rapidly from conception to completion. The OECD is now hoping that the world similarly implement its dictates without the careful consideration the subject demands.

It is paramount that Congress prevent the U.S. Treasury from unilaterally fulfilling the OECD's wish to rewrite global tax rules without democratic oversight. In particular, rules designed to enable global fishing expeditions on American businesses through demands for inordinate and unnecessary amounts of private and proprietary data should be rejected.

Far from acquiescing to the OECD's scheme, the U.S. should take a leading role in defending the principles of free and open markets, and call on other nations to similarly reject their demands.

For further substantiation of the OECD's motives and more in-depth explanation of the true costs of allowing BEPS to proceed, please consider the additional materials appended to this statement.

Coalition for Tax Competition

July 14, 2015

Dear Senators and Representatives:

The Organization for Economic Cooperation and Development (OECD) is rapidly working to rewrite global tax rules in the name of combating base erosion and profit shifting (BEPS). We the undersigned organizations are deeply concerned that this process lacks oversight and will result in onerous new reporting requirements and higher taxes on American businesses, and are urging Congress to speak up for U.S. interests by adding its voice to the process.

The OECD has a history of supporting higher tax burdens and larger government, and the BEPS project represents just the latest salvo in a long-running campaign by global bureaucrats to undermine tax competition and its restraining force on political greed.

Because the OECD is populated by tax collectors and finance ministers, new rules being drafted through the BEPS initiative are necessarily going to be skewed in their favor. Businesses are given only a token voice, while other interests are not considered at all. Consumers, employees, and everyone that benefits from global economic growth are not able to make their preferences known.

The inevitable prioritizing of tax collection over every other political or economic interest ensures that the result of the BEPS project will be economic pain. And based on the OECD's own acknowledgement that corporate tax revenues have not declined in recent years, that pain will provide little to no real gain to national treasuries.

BEPS recommendations already released further show a troubling trend toward excessive and unnecessary demands on taxpayers to supply data not typically relevant to the collection of taxes. This includes proprietary information that is not the business of any government, and for which adequate privacy safeguards are not and likely cannot be provided.

The Treasury Department should not be the only voice representing U.S. interests during this critical process. We urge members of Congress to get involved before it is too late, and to protect American interests by ensuring that the voices of tax collectors are not allowed to speak for everyone.

Sincerely,

Andrew F. Quinlan, President
Center for Freedom & Prosperity

Grover Norquist, President
Americans for Tax Reform

Pete Sepp, President
National Taxpayers Union

Michael A. Needham, CEO
Heritage Action for America

Tom Schatz, President
Council for Citizens Against Government Waste

Seton Motley, President
Less Government

Wayne Brough, Chief Economist and Vice President of Research
FreedomWorks

J. Bradley Jansen, Director Center for Financial Privacy and Human Rights

Phil Kerpen, President
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David Williams, President

Taxpayers Protection Alliance

Bob Bauman, Chairman
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Karen Kerrigan, President
Small Business & Entrepreneurship Council

Sabrina Schaeffer, Executive Director
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Heather Higgins, President
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BEPS Has Tax Competition in the Crosshairs

Brian Garst, Center for Freedom and Prosperity

Originally published October 2015 by *Offshore Investment*

The OECD's work on Base Erosion and Profit shifting is completing after what can only be described as an extremely rushed process by global policy standards. In an effort to understand the broader implications of the project and what it means for the future of international taxation, I authored a study published June 2015 by the Center for Freedom and Prosperity titled, "Making Sense of BEPS: The Latest OECD Assault on Tax Competition." [1] The following is an abridged version of the paper:

Introduction

Under direction of the G20, the Organization for Economic Cooperation and Development (OECD) began two years ago a major initiative on "base erosion and profit shifting" (BEPS). The project has garnered little interest from U.S. policymakers to date, yet its ever expanding scope and profound implications for the global economy should demand their attention.

In February 2013 the OECD released a report titled, "Addressing Base Erosion and Profit Shifting" (BEPS Report), declaring that, "Base erosion constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for OECD member countries and non-members alike." The OECD followed up with a plan in July 2013, "Action Plan on Base Erosion and Profit Shifting" (Action Plan), that identified 15 specific areas to address.

Through the BEPS project, the OECD is continuing its war against tax competition. Its proposals would enable endless global fishing expeditions and provide cover for governments to choke the economy with new taxes.

The Threat to the Economy

The OECD and other supporters of the BEPS initiative argue that there are economic benefits to preventing legal tax avoidance techniques. Namely, they contend that activity undertaken in response to tax policy represents a market distortion. In the narrow sense this is accurate, but as a justification for the OECD's current activities it falls short.

Typically ignored in the BEPS discussion are the broader implications of proposed reforms on the political economy. If all differences in tax policy were successfully minimized, to some extent it would indeed reduce profit-shifting aimed at suppressing tax burdens. So too would reducing taxes to zero, but policymakers have a variety of objectives to weigh and ought not elevate ending profit-shifting above all other national interests.

BEPS would lead to an overall higher tax environment as politicians freed from the pressures of global tax competition inevitably raise rates to levels last seen in the early 1980s, when reforms by Reagan and Thatcher sparked a global reduction in corporate tax rates that has continued to this day. Through tax competition, the average corporate tax rate of OECD nations declined from almost 50% in 1981 to 25% in 2015.

Taxes themselves distort the market by shifting resources away from market driven activities and toward politically driven activities, and higher rates, all else being equal, increase the effect of the distortion. Poorly designed tax systems – the global norm – introduce yet more distortions through the common practice of double taxing capital, which is of particular importance when discussing BEPS given that corporate taxes are often identified as the most destructive form of capital taxation, as even OECD affiliated economists have acknowledged.

Governments necessarily need taxes to fund essential functions, but ideally should seek to minimize the economic footprint of taxation as much as possible. Political incentives, however, often work in opposition of this goal. Politicians face pressure to demonstrate to constituents that they are performing and to please the interests that support their campaigns, and that in turn encourages taxes to rise above and beyond the level of optimum growth, or where new spending no longer provides net economic benefits.

Tax competition thus provides one of the main sources of push-back against the drive to spend and tax.

Tax collectors and finance ministers have inordinate say in the activities of the OECD, so it's expected that the BEPS initiative would represent their views above all else. The Action Plan thus considers the benefits of tax competition to be the real problem, explaining that "there is a reduction of the overall tax paid by all parties involved as a whole." The prospect of there being less money to be spent by politicians is perceived as a problem to be solved, rather than as a positive for the global economy.

The Threat to Privacy

Several BEPS action items raise serious privacy concerns. Proposed recommendations for transfer-pricing documentation and country-by-country reporting, for instance, feature broad reporting requirements that go far beyond what is required for purposes of immediate tax assessment.

Guidance for Action 13 recommends a three-tiered approach to transfer-pricing documents consisting of a master file, a local file, and a country-by-country (CbC) reports. Information contained in the local and master files are particularly vulnerable, since it would take a breach in only a single jurisdiction for it to be exposed. The OECD makes assurances for the confidentiality of these reports, but they are empty promises. Such government assurances of privacy protection are contradicted by experience and the long history of leaks of taxpayer information. In the United States alone tax data has frequently been exposed thanks to inadequate safeguards, or even released by officials to attack political opponents.

Even without malicious intent, governments are ill equipped to protect sensitive information from outside access. According to the U.S. Treasury Inspector General for Tax Administration, 1.6 million American taxpayers were victimized by identity theft in the first half of 2014, up from just 271,000 in 2010. Chinese hackers were blamed for a breach that exposed the data of four million current and former federal employees, and the massive new collection effort and reporting systembeing established to enforce the Foreign Account Tax Compliance Act has also been faulted for its insufficient privacy safeguards.

As poor as the United States has proven at protecting privacy, there are likely to be nations even more vulnerable. Through the master file and other reporting mechanisms, BEPS will demand of corporations propriety information and other sensitive data that they have every right to keep private and out of the hands of competitors. When it takes a breach of only a single national government to expose this information, there will no longer be such expectation of privacy.

Is BEPS a Serious Problem?

The OECD's website describes BEPS as “tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.” The BEPS Report further claims that, “it may be difficult for any single country, acting alone, to fully address the issue.” Or as the website more succinctly describes, BEPS “is a global problem which requires global solutions.”

No significant evidence for these assertions is provided, however. The OECD's BEPS Report itself undercuts the argument that there is a pressing need for a global response when it acknowledges that “revenues from corporate income taxes as a share of GDP have increased over time.”

Academic research on the impact of BEPS is far less certain than the rhetoric of the G20 and the OECD. The strongest analysis yet to date comes from Dhammika Dharmapala, whose survey of the literature reports that recent studies tend to find lower levels of shifting than earlier works. It also challenged arguments that “point to the fraction of the income of MNCs that is reported in tax havens or to various similar measures as self-evidently demonstrating ipso facto the existence and large magnitude of BEPS.” Simply identifying money in other jurisdictions, even those with low tax rates, is not evidence of a BEPS problem. It should be expected to see more money being earned where tax policy is less hostile.

Part of the reason there exists little evidence of a significant global BEPS problem is that domestic policy solutions are already available to address legitimate areas of concern when they arise. More importantly, the best solution available for preventing base erosion is the adoption of a competitive tax code. Pro-growth tax policy that eschews double and worldwide taxation not only won't cause capital flight, but will attract investment instead.

Broader Aims of the OECD

To fully understand the significance of the BEPS effort, it's necessary to place the current agenda within the broader context of the OECD's work in recent decades. In 1998 the OECD declared war on tax competition with a report entitled, “Harmful Tax Competition: An Emerging Global Issue.” Its authors worried that, among other things, tax competition “may hamper the application of progressive tax rates and the achievement of redistributive goals.”

The organization was eventually forced by political opposition to back away from explicit condemnations of all tax competition, but has not abandoned its views. Rather, it has adopted new tactics toward the same end. To make this point clear, the Action Plan favorably references *Harmful Tax Competition* as justification for its recommendations. It also repeats a popular but baseless theory among left-wing academics and politicians about tax competition – that it

promotes a 'race to the bottom.'

The 'race to the bottom' theory has claimed for decades that tax competition would force zero rates on mobile capital. It hasn't happened. One review of common such claims finds: “there can be little doubt that history has proven wrong the prediction of a complete erosion of capital tax revenue. Comparative data on corporate and capital tax rates demonstrate that governments in all economies continue to tax mobile sources of capital, effective capital tax rates have not changed much compared with the mid-1980s, when tax competition was triggered by the 1986 US tax act, and tax systems are as varied as countries and political systems themselves, with no visible sign of converging.”

Nevertheless, the BEPS report notes: “In 1998, the OECD issued a report on harmful tax practices in part based on the recognition that a 'race to the bottom' would ultimately drive applicable tax rates on certain mobile sources of income to zero for all countries, whether or not this was the tax policy a country wished to pursue.” Reality, essentially, is an unwarranted intrusion on the desire of policymakers to act without consequence. The BEPS report goes on: “It was felt that collectively agreeing on a set of common rules may in fact help countries to make their sovereign tax policy choices.” Unless, that is, their sovereign choice involves something other than raising taxes.

Nations that opt for little to no taxes on capital are a problem for this quixotic theory of sovereignty – where the rest of the world must be brought to heel in order to ensure that politicians ought not have to consider the economic consequences of their policies – hence why the primary indicator for determining whether a nation is to be identified as “potentially harmful” is that it has “no or low effective tax rates.”

Other factors are said to be considered, but without clear indication of how they are to be weighted any calculation will be arbitrary and open to excessive emphasis on the “gateway criterion” that is a low tax rate. When a low-tax scourge is identified, the OECD benevolently provides that, “the relevant country will be given the opportunity to abolish the regime or remove the features that create the harmful effect.” To make perfectly clear that this is the sort of offer a nation cannot refuse, they warn: “Where this is not done, other countries may then decide to implement defensive measures to counter the effects of the harmful regime, while at the same time continuing to encourage the country applying the regime to modify or remove it.”

The OECD's previous aggressions against low-tax jurisdictions in pursuit of its quest to abolish tax competition make clear just what “defensive measures” it has in mind, and how its members will go about trying to “encourage” compliance. In the years that followed release of *Harmful Tax Competition*, the OECD used threats of blacklists, peer pressure, and intimidation to cajole low-tax jurisdictions into adopting various policies presented under the auspices of increasing tax transparency and combating evasion. In practice the changes were intended to undermine the attractiveness of low-tax jurisdictions and protect high-tax nations from base erosion due to capital flight.

Of particular relevance for understanding the BEPS initiative is the pattern demonstrated by the OECD during the course of this campaign. After each recommendation was widely adopted – typically under duress in the case of low-tax jurisdictions – the OECD immediately pushed a new requirement that was more radical and invasive than the last.

The fact that the OECD is always ready with a new policy after one is implemented suggests either that the organization's goal is not merely what is stated, or that it is horribly ineffective. In either case it should serve as a blow to its credibility and a reason to question its work on BEPS.

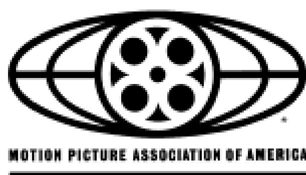
Conclusion

Were the OECD merely a research institution, its work could be dismissed simply as a bad idea that no nation need adopt. Unfortunately, Europe’s dominant welfare states use the OECD’s work as a benchmark when coercing other nations through use of political and economic leverage. For the low-tax jurisdictions, and now multinational businesses, caught in the OECD's crosshairs, the ride truly never ends. The BEPS project is a continuation of the OECD's well-documented effort to eliminate tax competition, and will likely follow the same pattern of consistently moving goalposts.

The BEPS project began at the behest of a tiny few, without open and public debate regarding the assumptions motivating the effort, its goals, or the most appropriate methods to achieve them. There is a lack of accountability, reflected in the activities of the BEPS initiative, that can only be rectified through real public debate and more direct political oversight.

END NOTES:

1. The full version is available at www.freedomandprosperity.org/2015/publications/making-sense-of-beps.



December 15, 2015

The Honorable Charles Boustany
Chairman
Subcommittee on Tax Policy
House Ways and Means Committee

The Honorable Richard Neal
Ranking Member
Subcommittee on Tax Policy
House Ways and Means Committee

Dear Chairman Boustany and Ranking Member Neal:

The MPAA and its member companies are grateful to you and your staffs for your efforts to reform the U.S. tax system. We very much appreciate the Subcommittee's recent hearing regarding the OECD BEPS recommendations and the potential effects on U.S. companies. We also are grateful for your collective efforts to develop an "innovation box" regime that encourages film and other IP development in the United States.

In that regard, we would like to submit the following comments for the record focused primarily on BEPS Action 5 and the need for the U.S. to adopt an innovation box to respond to actions being taken overseas. This is essential to encourage domestic innovation and development, to preserve and create well-paying U.S. jobs, and to generate economic growth in an increasingly competitive global marketplace.

Introduction

The MPAA's six members—Walt Disney Studios Motion Pictures, Paramount Pictures Corporation, Sony Pictures Entertainment, Inc., Twentieth Century Fox Film Corporation, Universal City Studios LLC, and Warner Bros. Entertainment Inc.—produce, distribute and export theatrical motion pictures, television programming, and home video entertainment. The studios typically license their IP directly, or indirectly through subsidiaries, to unrelated parties for distribution in U.S. and foreign markets. In exchange, they receive royalties that historically have been subject to tax in the United States.

The motion picture and television industry is an important productive component of the U.S. economy. The industry employed directly or indirectly nearly 2 million people in the United States in 2013 and generated $113 billion in wages. Core production, marketing, manufacturing, and distribution jobs paid an average of $84,000, which is nearly 70 percent higher than the national average. The industry is comprised of a nationwide network of tens of thousands small businesses across all 50 states, with 85 percent of these businesses employing fewer than 10 people. The industry also supports good jobs and wages in thousands of companies with which it does business, such as caterers, hotels, equipment rental facilities, lumber and hardware suppliers, transportation

vendors, and many others. Finally, the industry creates one of our country's most successful products, garnering a positive balance of trade with virtually every country to which we export and generating an overall $13.4 billion trade surplus in 2013.

Background – BEPS Action 5

Several countries have introduced favorable tax regimes for income that is derived from ownership of intellectual property. These "IP Box" regimes were enacted with the aim of attracting foreign investment and ownership of IP in the applicable country. Prior to BEPS and Action 5, such regimes generally have not required work related to the IP be carried out within the country in order to be eligible for IP box benefits. Thus, the tax benefit is currently not dependent on economic activity and innovation taking place in the jurisdiction.

Several other OECD countries had raised concerns that these types of regimes are "harmful" and artificially shift IP ownership and taxable profits away from the country or countries where the value of the IP is created. To address these concerns, the OECD released its final report on Action 5 "Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance" in early October. Under the final report, to avoid being labeled as "harmful," a preferential regime generally must require substantial economic activity occur within the country for a taxpayer to be eligible for IP box benefits. Specifically, Action 5 proposes that there must be a nexus between the income receiving the benefits and the expenses contributing to that income. Put another way, IP income will only qualify under this "nexus approach" for the preferential rates under an innovation box regime to the extent that the IP development expenses are incurred in the relevant country. Consequently, companies wishing to take advantage of the preferential regimes will need to shift at least a portion of their IP development (and associated jobs) overseas.

International Tax Reform and the Need to Adopt an Innovation Box

We believe one of the most important elements of tax reform will be to modernize our international tax system in order to put American companies on a level playing field when competing in the global market place. The current U.S. worldwide system is an outlier among major developed countries with its high statutory rates and the imposition of a residual U.S. tax on foreign earnings. This has a number of adverse economic consequences, causing our companies to be less competitive overseas, encouraging foreign ownership of IP, and locking out cash that could be used for domestic investment. Consequently, we agree with Chairman Brady's recent statement that we need to quickly conclude discussion on "international tax reform and an innovation box. It could be a significant down payment on overall tax reform, done right, allow[ing] U.S. companies to bring those stranded profits home to reinvest in the U.S. and ensur[ing] America isn't isolated on the innovation side of the economy."[1]

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[1] See Wall Street Journal, "Q&A: House Ways and Means Chairman Kevin Brady's Tax Plans," (November 6, 2015).

In addition to adopting lower statutory rates and a dividend exemption system, the U.S. needs to take specific steps to respond to BEPS and other developments overseas that, if left unanswered, will result in significant U.S. job and revenue loss. As noted above, other countries are aggressively seeking to attract IP creation and commercialization through the introduction of broad IP regimes and other incentives. In addition, with respect to films, many of our major trading partners (e.g., Australia, Canada, France and the United Kingdom) offer significant wage credits and other above-the-line incentives to attract film productions and jobs abroad, in addition to their lower statutory rates. For example, recognizing the benefits of film production to its economy, the United Kingdom this year sweetened its film and television production incentives by increasing its refundable tax credit from 20% to 25% for all qualifying U.K. film expenditure.

As described above, the nexus requirement under BEPS Action 5 will likely require companies to shift IP development and jobs overseas in order to take advantage of innovation box incentives. Because companies like ours are facing increased pressure from stakeholders to take advantage of these incentives, many will decide to locate IP ownership and a higher proportion of IP development functions overseas to establish the requisite "nexus" to claim such benefits or to justify a higher allocation of income attributable to that IP. This will cause U.S. tax revenues to shrink as the U.S. tax base attributable to IP decreases and credits for foreign taxes paid on IP developed and owned overseas increase.

To prevent greater migration of IP ownership and quality jobs to other developed countries, and loss of the associated tax revenue, we believe the U.S. needs to respond quickly by adopting an IP box that encourages the development, ownership and commercialization of film and other IP in the United States. Consequently, we want to commend and thank both of you and your staffs for the efforts to develop an innovation box proposal to counteract BEPS and other actions overseas, and help ensure that IP development and the associated well-paying jobs remain in the United States. We are particularly grateful that the discussion draft specifically includes films in the types of "qualified property" eligible for the innovation box deduction. This properly reflects the fact that production of films, like other forms of IP, is highly mobile and susceptible to other developed countries' incentives.

To ensure the purposes of adopting an IP box are fully met with respect to films, we believe that certain modifications should be made that properly account for differences between the development of films and other forms of IP. Most notably, the ratio in the discussion draft is based on incurring R&D expenses, rather than IP production expenditures generally. The production of films, in contrast to most other forms of IP, requires only limited R&D expenses. The numerator and denominator of the nexus ratio should be modified appropriately to reflect all IP development costs (incurred domestically compared to worldwide), not just R&D expenses. Also, the inclusion in the numerator and denominator of costs of an expanded affiliated group will often lead to anomalous results. For example, a corporation with significant business activities unrelated to development of IP, such as cruise ships, will be disadvantaged for no apparent reason relative to competitors without such activities. Conversely, a corporation

that has an affiliate with significant unrelated IP development activities could be advantaged relative to its competitors.

Also, similar to section 199, income derived from film-related copyrights and trademarks should be eligible for the deduction under the discussion draft, because such income is a significant portion of the film's revenue stream and is essential to the decision whether to produce a film or not.

In addition, on-line viewing is a rapidly evolving portion of the film and television market that should be encouraged. Congress recognized this when it specifically provided that the methods and means of distributing a film should not affect eligibility under section 199. Failure to extend eligibility for innovation box benefits to income derived from digital broadcasts could mean that, as the demand for digital programming grows, the intended tax incentive for domestic film production could shrink substantially over time.

Finally, we believe it is important that the benefits of an innovation box be available to partnerships, as well as corporations. A substantial number of film projects every year are produced through partnerships, co-productions and joint ventures. Film production by partnerships is also susceptible to foreign incentives and the effects of nexus requirements under BEPS. Thus, to counteract those incentives and preserve the U.S. revenue base and jobs, partnerships should also be eligible for innovation box benefits.

An alternative approach to implementing an innovation box in the U.S. would be to adopt an approach similar to the one taken by former Ways and Means Committee Chairman Camp in his tax reform bill (H.R. 1) to address base erosion.[2] By establishing a competitive tax rate on IP income and a balance between the treatment of exported IP and IP owned overseas, the "carrot and stick" approach of H.R. 1 will promote the creation, ownership and commercialization of IP in the United States.

The incentive effect of the "carrot" in H.R. 1 could be enhanced in several sensible ways. For example, the carrot will be heavily dependent on how intangible property development expenses are allocated for purposes of determining foreign intangible income. Specific rules are provided in the regulations under section 861 to allocate and apportion R&D expenses (Treas. Reg. sec. 1.861-17). These rules were adopted in part to encourage domestic research and development. Applying similar allocation and apportionment rules to film industry content and other intangible property for purposes of determining net foreign intangible income would provide similar incentives and help to ensure the carrot properly encourages domestic production of intangible property.

It would also enhance the "carrot" to specify that indirect expenses are not taken into account in computing net foreign intangible income. This would exclude expenses not directly allocable to IP development, including SG&A, stewardship and interest costs.

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[2] See H.R. 1, "The Tax Reform Act of 2014," sec. 4211.

A similar approach is used in Chairman Camp's discussion draft to define foreign source taxable income for purposes of the foreign tax credit limitation. This would provide a consistent approach for both purposes.

Finally, similar to the computation of the "stick" (which is done on a CFC-by CFC basis), net losses from one transaction should not offset net intangible income from other transactions in determining the carrot under the bill.

Conclusion

We are very appreciative of the ongoing work by the Committee and the Subcommittee to improve our tax system in order to promote domestic job growth and enhance the global competitiveness of U.S. businesses.

Our industry is highly sensitive to global competition. Recent technological developments have created an environment where jobs related to the production of underlying works, and the creation and commercialization of valuable intellectual property, are more highly mobile than ever before. Other countries are becoming more aggressive in using lower statutory tax rates, targeted tax incentives, broad innovation box regimes, and other subsidies to attract IP production and ownership overseas. Moreover, the OECD BEPS project has already caused a growing focus on the substance and extent of activities supporting the allocation of profits of a globally integrated enterprise. These actions by the OECD and other highly developed economies are creating a real and immediate threat to U.S. jobs.

We are grateful for your efforts to respond to these challenges so U.S. companies remain highly competitive overseas, and IP development (and the resultant jobs and revenue base) remain at home. We believe that a significant reduction in the U.S. corporate tax rate and adoption of a dividend exemption system with an appropriate innovation box will successfully achieve these goals.

Please contact Patrick Kilcur (202) 378-9175 if you have any questions or need anything else from us. We look forward to working with the Committee members and the staff on these important issues.

Sincerely,

Joanna McIntosh
Executive Vice President, Global Policy and External Affairs

cc:
House Ways and Means Committee Chairman Kevin Brady
Ranking Member Sandy Levin
Members of the Subcommittee on Tax Policy

Leading Innovation. Creating Opportunity. Pursuing Progress.

Statement for the Record

of Dorothy Coleman
Vice President, Tax & Domestic Economic Policy
National Association of Manufacturers

For the Hearing of the House Ways and Means Tax Policy Subcommittee

on "OECD BEPS Project final recommendations and its effect on worldwide American companies"

December 1, 2015

Statement for the Record by
Dorothy Coleman

For the

Hearing of the House Ways and Means Tax Policy Subcommittee

on "OECD BEPS Project final recommendations and its effect on worldwide American companies"

December 1, 2015

Chairman Boustany, Ranking Member Neal and members of the subcommittee, thank you for the opportunity to testify today about the Base Erosion and Profit Shifting (BEPS) project spearheaded by the G-20 and the Organisation for Economic Cooperation and Development (OECD). I appreciate the chance to highlight on behalf of the National Association of Manufacturers (NAM) our concerns about some of the recommendations in the BEPS project that would impose substantial and unnecessary compliance costs on companies and, in some cases, force disclosure of sensitive, confidential U.S. taxpayer information. These recommendations would create a new set of challenges for manufacturers and stand to harm our competitiveness in an already difficult global economic environment.

The NAM is the nation's largest industrial association and voice for more than 12 million women and men who make things in America. Manufacturing in the United States supports more than 17 million jobs, and in 2014, U.S. manufacturing output reached a record of nearly $2.1 trillion. It is the engine that drives the U.S. economy by creating jobs, opportunity and prosperity. The NAM is committed to achieving a policy agenda that helps manufacturers grow and create jobs. Manufacturing has the biggest multiplier effect of any industry and manufacturers in the United States perform more than three-quarters of all private-sector R&D in the nation – driving more innovation than any other sector.

Manufacturers know full well how critically important it is for U.S. companies to be able to invest and compete effectively in the global marketplace. Indeed, 95 percent of the world's customers are outside the United States. Investment by U.S. global companies has paid off for the U.S. economy: U.S. global companies employ 35.2 million workers and are responsible for 20 percent of total U.S. private industry employment[1]. Moreover, U.S. companies that invest abroad export more, spend more on U.S. research and development performed by U.S. workers and pay their workers more on average than other companies.

<u>Background</u>

In 2012, representatives from the G-20 asked the OECD to develop a comprehensive approach to address aggressive global tax planning that resulted in inappropriate corporate tax avoidance. The OECD released its final recommendations in October 2015 and the recommendations were approved by the G-20 Finance Ministers on October 9, 2015, and by the G-20 Leaders on November 16, 2015.

[1] Bureau of Economic Analysis, August 2014.

In July 2013, the OECD released the G20/OECD Base Erosion and Profit Shifting ("BEPS") Action Plan, which provided for 15 actions designed to reach consensus among members for recommended changes in tax policy. The BEPS Action Plan included Action 13, "Re-examine Transfer Pricing Documentation," to develop rules to require multinational companies (MNEs) "to provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template."

On October 5, 2015, the OECD released its final report on Action 13 (along with reports on all 15 BEPS Actions). The OECD identified Action 13 as one of the areas where all countries agreed to consistent implementation. The Action 13 report was virtually identical to an earlier draft (released in September 2015) and previously released implementation guidance (released in February and June 2015). Action 13 adopts a three-tiered approach to achieve transfer pricing documentation: a master file containing information to provide a complete picture of the MNE's global operations, including an organizational chart, consolidated financial statements, and analyses of profit drivers, supply chains, intangibles, and financing; a local file providing more detailed information relating to specific intercompany transactions of the MNE group impacting the specific tax jurisdiction; and a country-by-country report (CbCR) containing aggregated financial and tax data by tax jurisdiction. According to the OECD, the two documents that provide group-wide information – master file and CbCR – are intended to provide governments with information necessary to conduct high-level transfer pricing risk assessment.

The CbCR will only be required of multinational groups with annual consolidated group revenue of at least 750 million Euro in the immediately preceding year. The first CbCRs would be filed for tax years beginning in 2016 with the tax residence country of the parent of the MNE group (e.g., the United States for U.S.MNEs). Other countries could obtain CbCRs through exchange of information processes under bilateral treaties and tax information exchange agreements.

In order to obtain CbCRs, countries must agree to certain conditions related to confidentiality, consistency and appropriate use of the information. In this document, appropriate use is defined as "assessing high level transfer pricing risk" and "other BEPS-related risks." If the tax residence country of the parent company does not collect CbCRs, or has not agreed to provide CbCRs via information exchange, then other countries would be authorized to collect CbCRs directly from subsidiaries in their jurisdictions.

Action 13 includes model legislative language for adopting CbCR requirements and model competent authority agreements for use by governments to implement CbCR exchange. It also provides a detailed framework for confidentiality and data safeguards that need to be in place for countries to receive the CbCR through information exchange.

Under Action 13, the master file and the local file would be collected directly by each local jurisdiction in which the MNE conducts business. Confidentiality, consistency, and appropriate use standards that apply to the CbCR do not explicitly apply to the master file or local file, although participating countries have agreed that the confidentiality and consistent use standards associated with transfer pricing documentation generally "should be taken into account."

Potential Impact of the CbCR and Master File Requirements

The CbCRs on a company's financial and tax data that companies file with their own country could impose a significant, additional administrative burden on companies. These reports however, would be submitted to foreign countries under bilateral treaties and information exchange agreements and thus have protections to ensure confidentiality, consistency and appropriate use of the information by foreign countries.

Unfortunately, this would not be the case with the master file, which could be required directly by any country where a company does business. The master file asks for extremely sensitive information unrelated to actual taxpayer activities in the country requesting the information. In this way, the master file is similar to the CbCR. However, unlike the CbCR, the master file information does not have the confidentiality protections of the information exchange process and is not subject to any confidentiality, consistency, or appropriate use conditions beyond those that may apply locally.

If a country fails to abide by these conditions with respect to the CbCR, Treasury has stated its intent to suspend CbCR information exchange. To the extent this threat is effective in ensuring that other countries maintain confidentiality of CbCRs of U.S. MNEs, it is irrelevant to the master file, which is arguably more intrusive. With respect to maintaining confidentiality of the master file, U.S. MNEs are at the mercy of foreign governments.

Manufacturers are concerned that the master file requirement would force them to disclose an unprecedented amount of proprietary information about their global operations to foreign governments. The master file would include organizational charts, consolidated financial statements and analyses of profit drivers, supply chains, intangibles, and financing. In short, it would provide a comprehensive plan that includes every aspect of a company's worldwide business.

While a small amount of the required information in the master file may be contained in public filings with the Securities and Exchange Commission (SEC), most of the required information is descriptive in nature and even publicly traded companies will need substantial input from across the business enterprise to recompose the data. Information about global supply chains, for example, can be considered sensitive commercial information that, if disclosed, would be of high value to the MNE's market competitors. For privately held companies, the requirements to include a global organizational chart and consolidated financial statements would constitute an unprecedented level of disclosure to foreign governments. Disclosure, misappropriation, or inappropriate use of this information could be extremely detrimental to the ability of U.S. manufacturers to create value in the United States and global marketplaces.

The fact that taxpayers may have some level of control over what information is included in the master file does little to address confidentiality concerns since it is unclear how much flexibility taxpayers have to exclude sensitive information.

In the Action 13 report, the OECD recommends taxpayers use a "prudent business judgment" standard to determine the "appropriate level of detail" to be included in the master file. Information that is "important," however, cannot be omitted. The OECD considers information to be important "if its omission would affect the reliability of the transfer pricing outcomes."

Manufacturers believe that this standard provides little comfort for taxpayers that want to omit sensitive information and avoid penalties for failing to comply with the filing requirements. There is, at best, a questionable nexus between the master file information and transfer pricing outcomes within a particular country under the arm's length standard, since that is the purpose of the local file. For example, a taxpayer could reasonably take the position that omitting a global organizational chart or consolidated financial statements would not "affect the reliability of the transfer pricing outcomes" within any particular jurisdiction, yet be concerned that such omissions would constitute non-compliance.

Addressing Confidentiality Concerns

Even though the BEPS recommendations were finalized this fall, the NAM strongly believes that taxpayer confidentiality concerns can and should be addressed during the BEPS implementation phase. Specifically, we believe that Treasury should link master file information to its agreements to provide the CbCR to other countries through information exchange. Thus, we urge Congress to ensure that Treasury enters into agreements with foreign countries specifying that:

- Treasury agrees to provide CbCRs for U.S. MNEs only if U.S. MNEs or their subsidiaries are not required to provide master file information to the foreign country;
- The foreign country agrees that it will not collect CbCRs from U.S. MNEs or their subsidiaries; and
- Treasury agrees to provide to the foreign country only the master file information that a U.S. MNE chooses to file with its CbCR in order to provide context for its CbCR data.

Conclusion

NAM members recognize the crucial role tax policy plays in the ability of businesses around the world to compete and grow, and we support tax rules that are pro-growth, pro-competitiveness, fair, clear, and predictable. In contrast, the proposed information sharing and disclosure rules included in the BEPS recommendations described above would impose new and unnecessary compliance costs on companies and, in some cases, force disclosure of proprietary business information, creating a new set of challenges for global companies.

In particular, the master file requirement would provide foreign governments with a comprehensive roadmap detailing every aspect of a company's worldwide business. Many manufacturers in the United States with operations overseas would have to comply with this provision, which represents an unacceptable and unprecedented expansion of required proprietary data sharing and a very real competitive threat for some of America's most innovative firms.

Manufacturers are particularly concerned about the lack of safeguards to protect the confidentiality of this very sensitive information in the master file. Unlike the CbCR, the master file is not provided through information exchange and is not subject to any confidentiality, consistency, or appropriate use conditions beyond those that may apply in a local jurisdiction. If a country fails to meet these conditions on CbCRs, Treasury can suspend the information exchange. Unfortunately, this option does not apply to the master file information, which is even more intrusive.

On a positive note, the United States has not announced plans to collect the master file. We urge Treasury officials to go one step further and only provide CbCRs to foreign countries that do not require a master file. At a company's option, Treasury can provide any master file information the company chooses to provide as context for its CbCR data that is provided through information exchange.

When it comes to tax policy, manufacturers believe a fair and transparent tax climate in the United States—including competitive business tax rates and modern international tax rules—will boost standards of living and economic growth worldwide. At the same time, an appropriate balance needs to be struck between transparency and confidentiality of the proprietary information that enables companies to compete and prosper in a global economy.

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U.S. House of Representatives

Committee on Ways and Means - Subcommittee on Tax Policy

Hearing on the OECD Base Erosion and Profit Shifting (BEPS) Project

December 1, 2015

Submission of the Tax Innovation Equality (TIE) Coalition

The Tax Innovation Equality (TIE) Coalition is pleased to provide this statement for the record of the hearing in the Ways and Means Subcommittee on Tax Policy on the OECD Base Erosion and Profit Shifting (BEPS) Project.[1] As the statements from witnesses, Chairman Boustany and numerous others made clear, many of the concerns of both the U.S. government and U.S. businesses with the BEPS Reports would be alleviated by reforming the U.S. tax code. Therefore, as the Subcommittee considers what actions to take in view of the OECD BEPS Reports, we urge you to move forward with tax reform that will modernize the U.S. tax system and help American businesses compete in a global market. The TIE Coalition believes that the U.S. must: (i) implement a competitive territorial tax system; (ii) lower the U.S. corporate tax rate to a globally competitive level; and (iii) not pick winners and losers in the tax code by discriminating against any particular industry or type of income – including income from intangible property (IP).

Recognizing the importance of IP to the U.S. economy, many of the Members and witnesses at the hearing expressed concern about the adoption of so-called “innovation boxes” by OECD countries, raising questions about whether these measures will result in the movement of IP jobs from the U.S. to other countries and asking whether the U.S. should adopt similar measures. The TIE Coalition does not have a position on a U.S. “innovation box” but we are very concerned that in prior international tax reform proposals income from intangible property (IP) would be singled out for harsher tax treatment than income from other assets. By discriminating against IP income compared to income from other types of assets, these prior proposals would create an unfair advantage for companies who don’t derive their income from IP and significantly disadvantage the most innovative U.S. companies, especially compared to their foreign competition.

For example, the “Tax Reform Act of 2014” (H.R. 1), as introduced by former House Ways and Means Chairman Camp, would seriously disadvantage innovative American companies. Under

[1] The TIE Coalition is comprised of leading American companies and trade associations that drive economic growth here at home and globally through innovative technology and biopharmaceutical products. For more information, please visit http://www.tiecoalition.com/.

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that proposal, Chairman Camp chose to use what is now widely known as "Option C."[2] The problem with "Option C," is if it became the law of the land, its adverse tax treatment of IP income would significantly hinder U.S. companies who compete globally, and it would result in more inversions of U.S companies. The TIE Coalition is opposed to "Option C" because it would have a devastating impact on both innovative technology and biopharmaceutical companies.

In an effort to really understand the full scope of "Option C," the TIE Coalition earlier this year commissioned a study by Matthew Slaughter, the Dean of the Tuck School of Business at Dartmouth University. The January 2015 study, entitled "Why Tax Reform Should Support Intangible Property in the U.S. Economy" can be found at http://www.tiecoalition.com/why-tax-reform-should-support-intangible-property-in-the-u-s-economy and we urge the Ways and Means Committee to consider its findings when examining options for international tax reform.

As Dean Slaughter emphasizes, "Policymakers should understand the long-standing and increasingly important contributions that IP makes to American jobs and American standards of living – and should understand the value of a tax system that encourages the development of IP by American companies." The study finds that "Option C" in the Camp legislation would fundamentally change the measurement and tax treatment of IP income earned by American companies abroad. The study finds that "Option C" of the proposal would disadvantage IP income earned abroad by U.S. companies in three ways. First, it would tax IP income at a higher rate than under current law. Second, it would tax IP income more than other types of business income. Third, it would impose a higher tax burden on the IP income of U.S. companies compared to their foreign competitors. The likely outcome of using "Option C" as proposed in the Camp legislation would be to increase corporate inversions and incentives for foreign acquisitions of U.S. based IP intensive companies.

The Slaughter study finds that the "United States, not abroad, is where U.S. multinationals perform the large majority of their operations. Indeed, this U.S. concentration is especially pronounced for R&D, which reflects America's underlying strengths of skilled workers and legal protections such as IP rights that together are the foundation of America's IP strengths, as discussed earlier." The Slaughter study concludes that the overseas operations of these companies complement their U.S. activities and support, not reduce, the inventive efforts and related jobs of their U.S. parents. So it is increasingly important to America's IP success that these companies continue to operate profitably overseas and any tax reform proposals do not impose discriminatory taxes on income from intangible assets located there.

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[2] Please note that the TIE Coalition is opposed to both versions of "Option C" (version one of "Option C" in the Camp Draft and version two of "Option C" in H.R. 1 as introduced).

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Working Together for Tax Innovation Equality

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IP jobs are very important to the U.S. economy and make up a large portion of the workforce. That is why it is important to have a tax code that supports the IP economy here in the U.S. To that point, the U.S. Chamber's Global Intellectual Property Center commissioned a study on the benefits of IP jobs to economic growth in the U.S. The study found that in 2008-09 that there were 16% or 19.1 million direct IP jobs and 30% or 36.6 million indirect IP jobs in the U.S. IP or IP related jobs account for 46% of the U.S. economy or 55.7 million jobs. With our modernizing economy it is likely that this number has grown.3

To be constructive and help the Subcommittee find solutions that will allow American companies to succeed in a very competitive global market, the TIE Coalition has developed anti-base erosion solutions that do not target IP income. We would like to work with the Subcommittee to develop alternative options that would apply to situations in which companies are simply trying to shift income to low tax jurisdictions with no substance or real business presence, but would not discriminate against income from intangible assets. Such options would apply to income from all goods and services, not just income from intangible assets.

In conclusion, the TIE Coalition supports tax reform that modernizes the U.S. tax system, allowing American businesses to compete in global markets in a manner that does not discriminate against any particular industry or type of income, including income from intangible property. As the witnesses at this hearing indicated, many other countries are lowering their corporate tax rates and adopting tax rules to attract IP companies to their shores. So, it would be especially harmful to the U.S economy to adopt a tax policy that will hurt, not help, American companies who compete globally. Now is not the time to drive high paying American jobs overseas.[4]

[3] See, http://image.uschamber.com/lib/fee913797d6303/m/1/IP+Creates+Jobs+-+Executive+Summary+Web+-+2013.pdf

[4] The U.S. Chamber study found that "IP-intensive companies added more than $2.8 trillion direct output, accounting for more than 23% of total output in the private sector in 2008-09" and that the "Output per worker in IP-intensive companies averages $136,556 per worker, nearly 72.5% higher than the $79,163 national average. Id.