

# Base Erosion and Profit Shifting: Governments' Policies vs. Corporate Strategies

May 21, 2014  
Bocconi University, Milan

Daniel Shaviro  
NYU Law School

# Questions

- What can/should a large country (the US) or set of countries (the EU) do about BEPS if acting unilaterally?
  - With respect to outbound investment by resident multinationals;
  - With respect to inbound investment by foreign multinationals.
- How does this change if countries cooperate?
- How much cooperation is feasible / needed?

## What can/should a large country or countries do unilaterally?

- A natural starting point would be to seek neutrality between purely domestic activity and that by multinationals.
- But since MNEs are more mobile, one might prefer taxing them at a lower effective rate (and without express tax rate differences). Consider earnings-stripping rules.
- The OECD BEPS project may reflect a view that MNE tax planning has gone too far.

## US vs. EU anti-BEPS rules

- The US can do what it likes (subject to market forces & concern about comity) with its rules for corporate residence, source, subpart F, etc.
- Note the US legal status of treaties.
- The EU has additional internal legal constraints given ECJ oversight, internal heterogeneity.

# Taxing MNEs: how vs. how much?

- Again, the goal might be to allow “some” scope for MNE tax planning (hard to foreclose in any event), but not “too much.”
- This could involve a dramatic change in approach (worth reviewing briefly though highly improbable even unilaterally).
- Or it could involve adaptation and revision of familiar existing tools.

“When you come to a fork  
in the road, take it.”

- Shaviro 2014: tax rate on FSI should be  $> 0$  but much lower than domestic rate; no FTCs or deferral; neither a territorial nor a WW system as under current practice.
  - Although it rejects concern about “double taxation” in favor of “not too high or too low,” potentially treaty-compatible.
  - No major advances offered re. residence or source rule design, but seek “costlier electivity.”

## Unilateral action within the current structure

- Corporate residence electivity is a rising problem, under both HQ and POI rules.
- Residence matters if one wants to tax FSI either for its own sake or to backstop the domestic tax base.
- With deferral, huge “exit” problems – US backstopping is starting to erode (e.g., Pfizer/Astra Zeneca).
- Use both HQ and POI? Coordination issue.
- Exit taxes for companies, based on unrepatriated foreign earnings, also worth considering.

# Available tools for resident companies vs. non-residents

- For source, can use transfer pricing, interest expense rules, etc.
- While in theory can apply to all companies, in practice may look through more to resident companies' CFCs.
- “Subpart F et al” can only apply to companies that are classified as residents.
- I define this to include not just US-style anti-deferral rules, but also territorial rules limiting exemption.



# Source rules vs. subpart F-style rules

- The former have the virtue of more readily applying to all MNEs, but formally or on their face raise greater coordination issues.
- The latter typically address tax haven concerns by either of two mechanisms.
- The first is to tax income actually reported as arising in a tax haven; the latter is to address highly mobile income by type (passive, etc.).
- No need to claim that “subpart F” income is actually domestic, but again, can’t apply to “non-residents.”

# The limits to unilateral action

- All the tools are bad – reflecting inherent weakness of the source & residence concepts, but also needlessly bad present law structure.
- Treating formal legal lines between commonly owned entities as consequential is bound to play out badly.
- The US is already learning how intolerable FTCs may be absent deferral (which itself is becoming intolerable).
- Formulary approaches no panacea, but aim for costlier electivity than today's transfer pricing.

# A case for broader cooperation?

- OECD / BEPS is giving this a shot.
  - Despite my best wishes, I confess to not being wildly optimistic.
  - Countries that are similar have good reason to cooperate, & can hope for mutual advantage from doing so.
  - Widespread FTCs, reciprocally granted by peer countries, used to be an example of this.
  - The problem is heterogeneity – an issue on the low-tax end even just within the OECD & EU. And will the US play ball?

## How much broader cooperation is needed?

- Clearly, high-tax countries need broader cooperation in information reporting to meet their objectives.
- But one could easily exaggerate the need for prearranged substantive cooperation.
- E.g., internal trade within the US has survived despite some heterogeneity in the states' approaches to formulary apportionment.

## What if countries' sourcing rules differ?

- Many exaggerate the importance of taxing everything exactly once.
- The point, rather, is to have reasonable overall tax burdens on cross-border activity (keeping rate differences in mind).
- Countries should therefore be willing to consider acting first, without broader consensus, & then discussing coordination with peer countries.

## Unilateral changes & the potential for emergent cooperation

- Some types of unilateral rule changes might encourage / invite broader adoption.
- E.g., suppose the US or EU were to move unilaterally towards well-designed sales-based FA &/or truly global, group-wide interest allocation.
- This would disadvantage peer countries that stuck with current-law approaches – but perhaps not if they followed suit.