OECD-BEPS: A quick guide for the perplexed

Daniel Shaviro, NYU Law School
ABA Section of International Law,
April 14, 2016
What is BEPS?

OECD: “Stated simply, tax base erosion and profit shifting (BEPS) arises because under the existing rules it is possible to artificially separate the allocation of taxable profits from the jurisdictions in which these profits arise.”

2013: OECD instructed to develop analysis & proposals regarding how countries could respond.

Final report issued 2015 after extensive public discussion & debate.

Countries around the world are deciding if / how to respond.
15 Actions around 3 main pillars

Coherence
- Hybrid Mismatch Arrangements (2)
- Interest Deductions (4)
- CFC Rules (3)
- Harmful Tax Practices (5)

Substance
- Preventing Tax Treaty Abuse (6)
- Avoidance of PE Status (7)
- TP Aspects of Intangibles (8)
- TP/Risk and Capital (9)
- TP/High Risk Transactions (10)

Transparency
- Measuring and Monitoring BEPS (11)
- Disclosure Rules (12)
- TP Documentation (13)
- Dispute Resolution (14)

Digital Economy (1)

Multilateral Instrument (15)
What triggered OECD-BEPS?

Multinationals have gotten ever better at creating “stateless income” (effectively taxed nowhere).

Causes include the rising importance of IP, falling transportation & communication costs, rise of global production networks, changes in tax rules & tax planning “technology,” role of tax havens, etc.

For a long time, this was actively tolerated by both residence & source countries.

But at a certain point, many decided that it had gone “too far.”

This reflected (1) sheer amount of “stateless income,” (2) investigative journalism (using official reports & academic research), (3) politics post-2008 and post-Piketty, & (4) EU concern about U.S. companies.
The key: foreign-to-foreign tax planning

Most big companies still mainly (a) reside in “big” countries with real tax systems, & (b) are active economically in such countries.

So the key is “foreign-to-foreign” tax planning – diverting reported profits from home & true source countries to tax havens.

So two puzzles to think about:

(1) Why would a residence country object to foreign-to-foreign tax planning? From the domestic standpoint, foreign taxes are just a cost.

(2) Why don’t source countries protect themselves more? After all, they’re the ones losing revenue in the first instance.

But in fact, both sides should sometimes like, & sometimes dislike, foreign-to-foreign tax planning.
The residence country perspective

The best rationale for impeding foreign-to-foreign tax planning is that it’s backdoor residence tax base protection.

Once income is labeled as foreign source, getting it to a tax haven is much easier.

If can’t convert domestic source income into foreign source income, foreign-to-foreign tax planning is good for the “home team” – but when & to what extent should one think of it as fixed? (Actual shifts, reporting shifts)

This conundrum leads countries to act ambivalently / inconsistently, as in the long & twisting saga of U.S. international taxation.

It also explains the lack of scholarly consensus on these questions.
The source country perspective

While impeding profit-shifting is hard, source countries have long been more tolerant than they needed to be.

It’s targeted tax competition – lower effective tax rates for mobile inbound investment – that needn’t be explicit or acknowledged.

But once it went “too far,” & especially with tight budgets, austerity, & concern about high-end inequality, many countries got concerned.

U.S. companies’ tax planning is the best-known, reflecting high quality of the U.S. tax press (& outstanding U.S. researchers, Capital Hill hearings / reports).

This has created a bit of a U.S. vs. EU story, reflected in EU “state aid” cases & in the Obama Administration’s response to OECD-BEPS.
How will OECD-BEPS play out?

Yogi Berra: “It’s tough to make predictions, especially about the future.”

For once, Yogi was wrong: it’s actually quite easy to make predictions! People do it all the time.

But it’s hard if you care about being right.

My best guess is that the upshot of OECD-BEPS will be anti-climactic – but perhaps my knowing the U.S. scene best makes me too pessimistic.

More generally, it seems to be the case that both “Something must happen” & “Nothing can happen.”