The Case Against BEPS: Lessons for Coordination

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Outline

• Why BEPS now?
• Problematic Premises
• Lead to Poor Outcomes
• Addendum: Recent Developments
What is BEPS

• Action plan to combat base erosion and profit shifting by multinational enterprises

• 15 “action items”

• Supposed to prevent multinationals’ profits from being able to obtain status of “double non-taxation” or “stateless income”
BEPS Recommendations

- Recommendations for changes in domestic laws
  - Interest expense deductibility
  - Hybrid Instruments
- Revisions to treaties (MLI, principal purpose test)
- Modifications to the OECD transfer pricing guidelines
- Transparency, exchange of information, harmful tax practices
- Studies and reports not recommending particular rule changes
  - Digital economy
  - Quantifying BEPS
Why BEPS Now?

• Inequity and the financial crisis
• Digital Economy
• Political Cover for Politicians
• Global Power Shifts
• The OECD’s role
Weak Foundations

• Coordinated effort mostly ignored the underlying issues that gave rise to the challenges that the project was supposed to address

• Global Politics
  • No agreement on allocation
  • Challenges of focusing on value creation
  • Source v residence
  • Shifts in balance of power
Weak Foundations

• Domestic Politics
  • Power to tax = political power
  • Need to encourage investment
    • Patent box

• Value Creation
  • Never defined
  • Never acknowledged its departure from prior principles
Poor Outcomes

• Minimum standards or lack thereof
  • Four minimum standards
• U.S. Non-Participation
• Digital Economy
• Other hard questions pushes aside (profit split, attribution of profits)
• Vague Rules
  • Transfer Pricing Guidelines: Deliberate Incoherence?
  • Permanent Establishment Standard
Conclusion

• Differing objectives among participants led to unsatisfactory outcomes
• Attempts at coordination led by developed countries are doomed to be unsuccessful because they lack full participation from non-OECD global economic players, are based on incoherent principles, and fail to take account of strong nationalist interests
• To really address the larger (unacknowledged) challenges, need a reexamination of underlying principles and broad agreement on such principles
• Need to formulate goals for an international tax system that take into account both global inequalities and the benefits countries obtain from tax competition
Addendum – Subsequent Developments

• Digital Economy:
  • Top priority item now revived with draft recommendations due next April
  • No closer than they were 2 years ago
  • Focus on short term to “keep the pressure cooker from exploding”
  • But the U.S. seems unlikely to agree to any proposed solution
  • Interaction with U.S. tax reform – could make BEPS moot?
Addendum – BEPS Implementation

• Multilateral instrument: principal purpose test
• Country by country reporting
• Gary Sprague presentation at digital economy consultation: BEPS is having an impact and new PE definition is prompting companies restructure their distributorship operations
Addendum: US Tax Bill

• Anti-base erosion measures
• Competitive lower corporate rate
• Spillover effects