Plus ça change, plus c'est la même chose

The remarkable persistence of international tax norms over a turbulent century

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The BEPS Revolution.
or is it?

Revolutionary

Come the full circle
(Nothing new under the sun)
(Avi Yonah)

Merely continuing down the same path
(Sadiq and Krever)

The BEPS Revolution
or is it?

- Claims:
  - the world's first global multilateral tax treaty
  - a formulary apportionment regime that looks at sales as a profit source factor
  - the demise of transfer pricing and corporate tax havens with a global minimum tax (GloBE)

A global multilateral tax treaty

A world first multilateral treaty. Or is it?

- Is the MLI just another OECD treaty? The world's most important economy not a party to the MLI and crucial articles in the "multilateral" treaty are accepted only by OECD members and a handful of others

- Impact outside the OECD: over 100 signatories but two-thirds did not sign on to mandatory arbitration, for example

A dramatic shift from arm’s length to formulary apportionment

Arm’s length to formulary apportionment. Or is it?

- the world was moving to sales as a factor in the source of income (“Amount A”) before Pillar 1 and it will happen whether or not the Pillar 1 is implemented
- unilateral measures are much broader than Pillar 1
- based on the agreed Pillar 1 threshold of profitability of 10% (and given that financial and extractive companies are excluded), only 78 of the world’s 500 largest companies will be affected (Devereux & Simmler)

Examples of unilateral measures

- US, Canada and (when it had state income taxes) Australia had formulary apportionment including sales
- some US states dropped capital and income and only use sales or double weight sales
- 2011 CCCTB, 2016 relaunched, 2021 BEFIT
- 2016 India introduced equalisation levy (precursor to DSTs) – adding sales to the calculation
- 2019 Europeans started to adopt DSTs – based on sales
- Chinese announced they would use “locational advantage” in profit split calculations – based on sales

GloBE, transfer pricing and tax havens
Or is it?

- Is GloBE the end of transfer pricing or an explicit reaffirmation of current profit allocation rules and the right of companies to shift profits via transfer pricing?
- One African country will sign on – tax sparing by the rest of the world?

Plus ça change, plus c'est la même chose

A new tax system or tactical reinforcement of the old?

Income taxes

- 1799 UK Income tax Act (schedular)
- US and Canadian colonies followed with limited levies
- 1851 Prussian income tax (evolved from land and class tax)
- 1861 US Income Tax Act
- 1891 Prussian income tax, full income tax
- 1894 US Income Tax Act, re-enacted 1913
- early 1900s US state income tax
- early 1800s municipal income taxes in Canada; early 1900s became provincial income taxes
- 1913-1919 widespread adoption by national governments

The source of income

- All jurisdictions claimed the right to tax income sourced in the jurisdiction

- two views of the source of income:
  - 1869 Prussian-Saxon treaty – where business is located (start of the PE concept) (also introduced the residence and source concepts into a treaty)
  - look at the factors that give rise to profits (where value is actually created)

Double tax relief

- national income taxes spread just before, during and after WW1
- many taxed on the basis of residence and source, leading to a potential double tax problem
- solved unilaterally by all countries: initially exemption or deduction
- US and UK and all deduction countries eventually moved to credit

Effect of double tax relief

- Exemption: only source country has taxing rights

- Credit: source country has first taxing rights; residence residual rights if it has a higher tax rate

Committee of Experts

- League of Nations asked to look at double tax relief and allocation of profits
- four experts: Italy, UK, Netherlands, US (Seligman) – why a US expert?
- report said an enterprise is a single economic entity, however it divides itself legally: profits should be allocated where value is created (inputs) and where sales take place
- formulary apportionment support is attributed by many to US state formulary apportionment
- Avi-Yonah full circle thesis: Pillar One is Committee of Experts report adopted

League of Nations Committee of Experts

- First proposed multilateral treaty but this didn’t fly
- Then, proposed bilateral treaty but formulary apportionment
- US perspective: foreign tax credit system – ideal is no tax abroad for US MNEs
- Formulary apportionment (allocating where input value is created and output sales occur) was a significant threat

League of Nations and Mitchell B. Carroll

- any tax payable abroad by a US company would reduce US taxes payable
- sent Mitchell B. Carroll to tax treaty meetings
- final model removed some taxing rights for source country (capital gains, business profits) or capped them (interest, dividends, royalties)
- arm's length system and recognition of each part of an MNE as a separate entity
- result was transfer pricing and profit shifting

BEPS

History of BEPS: How did we get here?

- Commonly traced to work commenced by the OECD starting in the mid-1990s on “harmful tax competition”.
- 14 November, 2008, inaugural leaders summit of the G20, the US joined with other leaders in calling on the OECD to continue efforts to promote tax information exchange.
- 2 April, 2009, the second leaders meeting called on the OECD to continue efforts to eliminate tax secrecy, prompting the OECD to expand its tax initiative to a “Global Forum on Transparency and Exchange of Information for Tax Purposes”.
- 2012, leaders of the Group of 20 (G20) set the OECD an ambitious agenda of working out how tax base erosion and profit shifting could be addressed.

History of BEPS: From Evasion to Avoidance

- 2001 attack on the World Trade Centre accelerated the program of work to address secrecy and evasion.
- 15 September, 2008, Lehmann Brothers collapsed.
- Not until *after* the 2009 G20 meeting that governments realised they were bankrupt, with Greece and Iceland having to pay off IMF bailouts and many others in difficulty.
- This prompted the shift from secrecy and evasion to profit shifting and the allocation of MNE profits.

History of BEPS: Post 2012 OECD Response

- 2013, the OECD released a report on how base erosion and profit shifting could be tackled followed by an Action Plan setting out the areas to be addressed.
- 2015, Fifteen Actions were developed and presented to G20 finance ministers.
- 2016, "inclusive framework" established to open the BEPS program to non-OECD members.
- 4 minimum standards:
  - Action 5, harmful tax practices
  - Action 6 tax treaty abuse as set out in, adopting a
  - Action 13 country-by-country reporting
  - Action 14 cross-border tax dispute resolution
- Over 140 countries currently signed to the inclusive framework.

History of BEPS: A Multilateral Treaty

- Early 1980s, the OECD and Council of Europe developed a Convention on Mutual Administrative Assistance in Tax Matters.
  - Signed in 1988, the convention became effective in 1995.
- Prior to the BEPS project, the implementation of further multilateral tax agreements outside economic or political communities still seemed unlikely.
- The global financial crisis and elevation of the OECD's anti-tax haven program into a full-blown assault on international tax avoidance proved to be a game changer, however.
- In mid-2017, a Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (Multilateral Instrument or MLI), a key Action in the BEPS program, was signed initially by 67 jurisdictions.
- 2023 = 100 signatories.

History of BEPS: BEPS 2.0

- BEPS 2.0: Outcome of Action 1 of the BEPS Program
- 2021, OECD’s Two-Pillar global agreement seeks to address two distinct issues:
  - Pillar One addresses the inability of consumer countries (market jurisdictions) to tax profits of foreign providers of goods and services
  - Pillar Two addresses profit shifting by multinational enterprises.
- The first issue arises because the “source of profit” rules do not attribute profits of foreign goods and services providers to the location of customers.
- Pillar Two is intended to mitigate profit shifting arrangements by MNEs to lower their tax base.
- Pillar Two would ensure that profits shifted abroad were subject to a minimum tax of 15%.

Arm’s Length System v Formulary Apportionment

Arm’s length, water’s edge system = separate entity system

1. Every part of the single enterprise is treated as a separate taxpayer
2. The taxpayers can elect how to allocate profits provided they use “arm’s length pricing”
3. Since transactions are based on group synergy, they would not take place outside a group – no comparables and taxpayer nominates arm’s length price
4. Source = where value is created for inputs; value creation = where result of efforts is transferred

Formulary apportionment

1. Profits allocated to actual source countries;
   source = where value is created for inputs and where sales take place for outputs

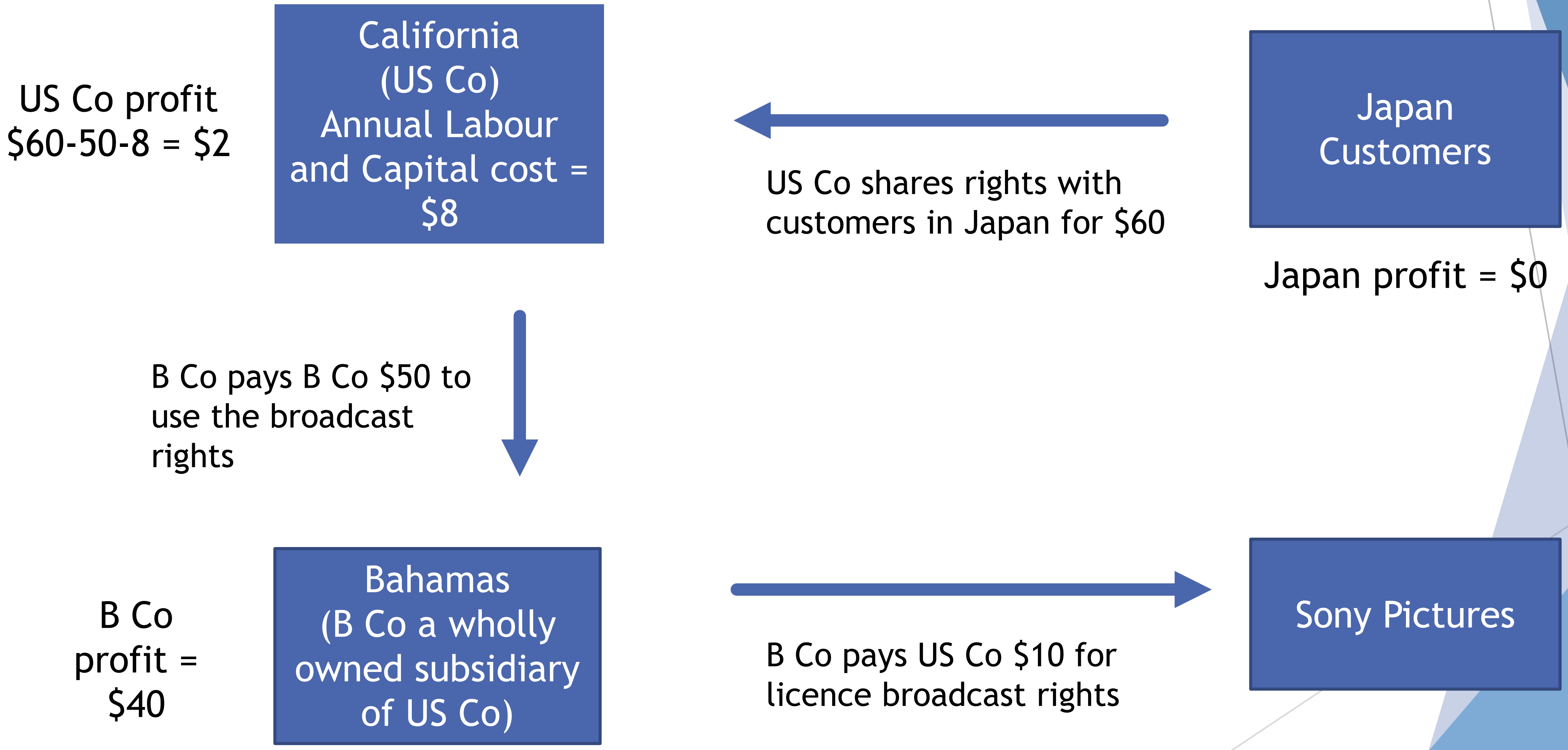
Arm’s Length System v Formulary Apportionment

Arm’s Length System v Formulary Apportionment

source: where value is created:
Cupertino, California?
Bahamas?
Australia?


NETFLIX
ログイン
出会えば、はじまる。
映画やドラマをもっと自由に。
いつでもキャンセルOK。
まずは1ヵ月無料体験
PRISON BREAK
斉木楠雄のΨ難
GODZILLA
DEVILMAN crybaby
TERRACE HOUSE
SUICIDE SQUAD
ポプテピピック

Business Location View (legal presence)



Arm’s Length System v Formulary Apportionment

Factor View

California
(US Co)

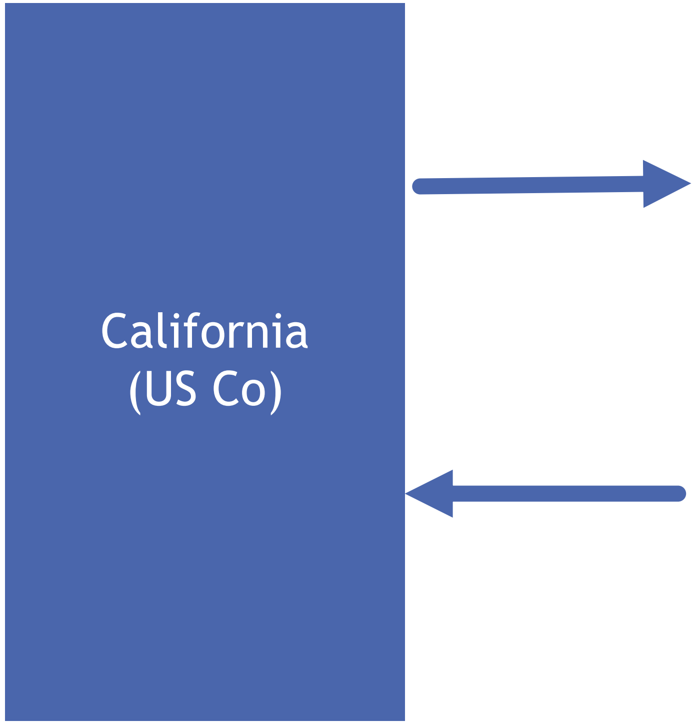
Annual Labour and Capital cost = 8
Licence Fees to Third Parties = 10

Sales to Japan = 60

PROFITS OF THE CORPORATION = 42

WHERE IS THIS SOURCED?

Factor View



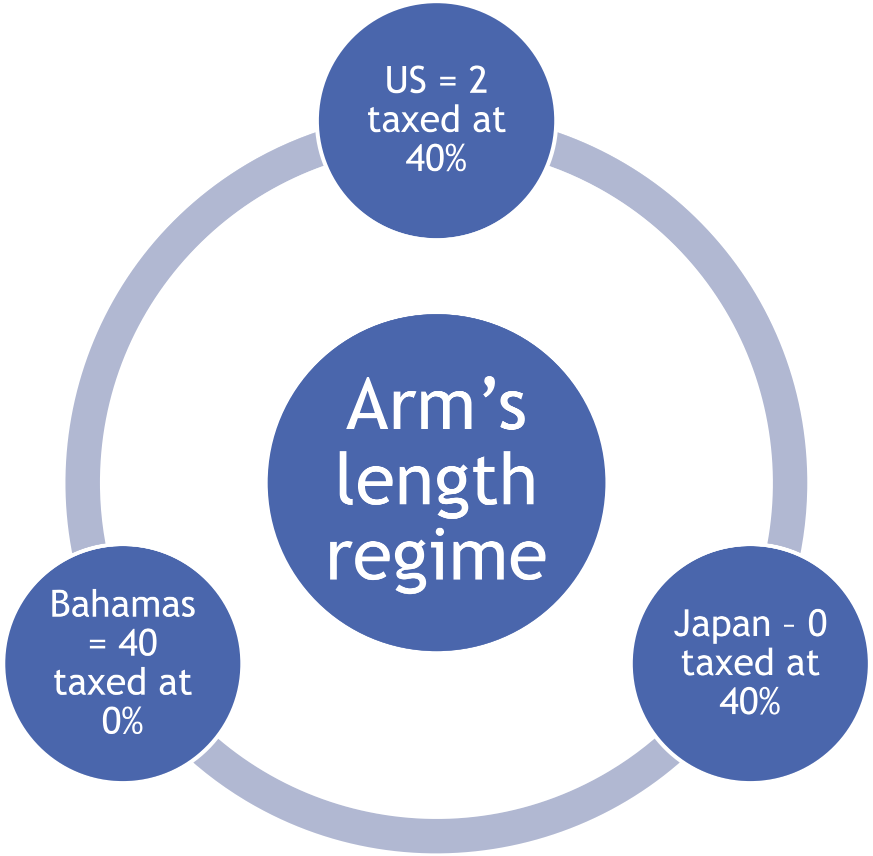
Annual Labour and Capital cost = 8
Licence Fees to Third Parties = 10

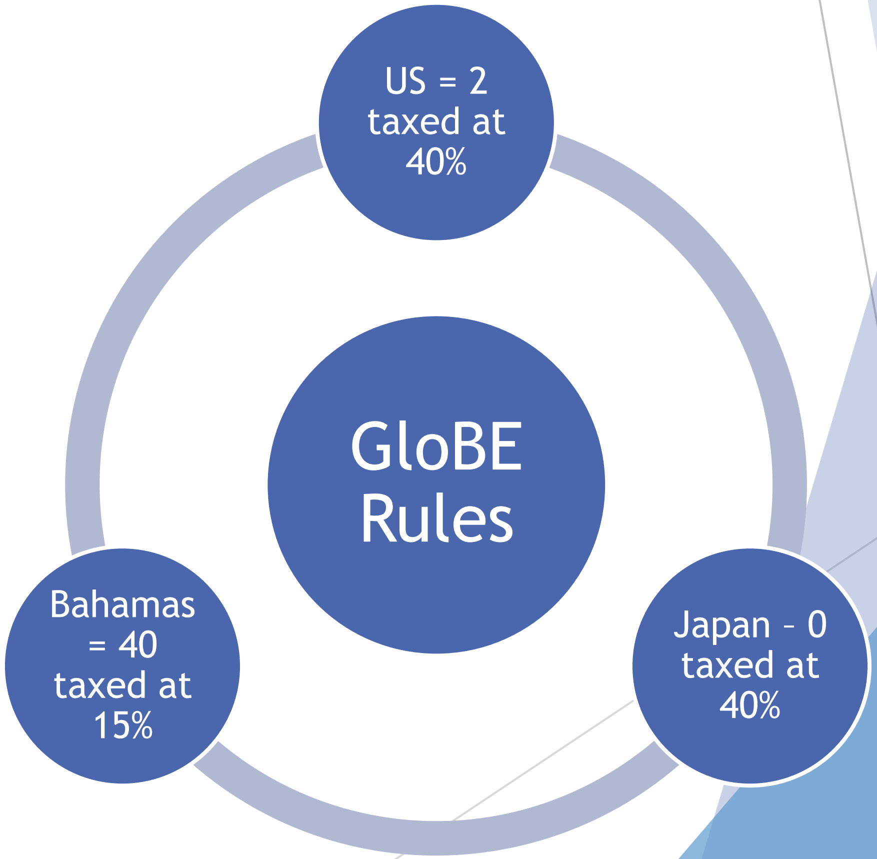
What if Japanese consumers were:

1. only willing to pay 18?
2. what if they were only willing to pay 16?
3. what if they were willing to pay 60?

Global Minimum Tax (Global Anti-Base Erosion = GloBE) rules

Using the same scenario, assume the corporate tax rate is 0% in the Bahamas and 40% in Japan and the US





Total Tax Revenue under alternative models

Arm’s Length System	GloBE System	Formulary Apportionment
Total tax 2 x 40% = 0.8	Total tax 2 x 40% plus 40 x 15% = 6.8	Total tax 42 x 40% = 16.8

Path dependency or deliberate defensive policy?