INTERNATIONAL TAX AND INVESTMENT CENTER

# Issues Paper

International Tax and Investment Center December 2014

# The Brisbane G20 and Cairns Communiqué and Recent Developments in the Forum on Tax Administration: Implications for Business

by

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## Brisbane Communiqué

The Brisbane communiqué contained one paragraph on tax. It read:

> *13. We are taking actions to ensure the fairness of the international tax system and to secure countries' revenue bases. Profits should be taxed where economic activities deriving the profits are performed and where value is created. We welcome the significant progress on the G20/OECD Base Erosion and Profit Shifting (BEPS) Action Plan to modernize international tax rules. We are committed to finalizing this work in 2015, including transparency of taxpayer-specific rulings found to constitute harmful tax practices. We welcome progress being made on taxation of patent boxes. To prevent cross-border tax evasion, we endorse the global Common Reporting Standard for the automatic exchange of tax information (AEOI) on a reciprocal basis. We will begin to exchange information automatically with each other and with other countries by 2017 or end-2018, subject to completing necessary legislative procedures. We welcome financial centers' commitments to do the same and call on all to join us. We welcome deeper engagement of developing countries in the BEPS project to address their concerns. We will work with them to build their tax administration capacity and implement AEOI. We welcome further collaboration by our tax authorities on cross-border compliance activities.*

There are three key elements of the communiqué that are particularly relevant for business:

### 1. "We welcome the significant progress on the G20/OECD Base Erosion and Profit Shifting (BEPS) Action Plan to modernize international tax rules. We are committed to finalizing this work in 2015."

Reconfirming the G20 commitment to the broad policy principles of the BEPS Project and endorsing the Common Reporting Standard for automatic exchange of tax information on a reciprocal basis have become the bedrock of recent messaging.

The last phrase recognizes that all the BEPS actions are closely interlinked and that nothing is agreed until everything is agreed. The OECD may find it harder to obtain consensus as countries started to firm up their positions. With the dates of the BEPS Action Plan inextricably linked to the political calendar and therefore immobile, this has led to some issues being carried over for continued work where full agreement could not be reached. Indeed, only two of the September 2014 BEPS reports were delivered in final form. This phrasing from the communiqué demonstrates that the OECD is highly aware of the facts that not only are some countries forging ahead with unilateral actions but that business is less likely to make significant investments during a period of such tax uncertainty.

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### 2. "...including transparency of taxpayer-specific rulings found to constitute harmful tax practices."

This passage reflects the spontaneous exchange of tax rulings made by a country that will be required under BEPS Action 5 (Countering Harmful Tax Practices). It reflects a substantial increase in interest in this area of taxation in recent months, in part due to the Luxembourg revelations just before the summit.

The September 2014 report in relation to BEPS Action 5 defines a framework for compulsory spontaneous information exchange on rulings. According to the report, this framework should be applied to rulings that are specific to an individual taxpayer who takes benefit from a harmful preferential regime and should not cover general rulings. The report addresses questions related to when the exchange of such information should occur, with whom, what information should be considered and on what legal basis. The report proposes a flowchart presenting the different steps and tests which should be pass through to decide whether a country should spontaneously exchange information concerning a ruling. The approach targets only rulings related to harmful preferential regimes that are within the scope of work of the OECD's Forum on Harmful Tax Practices (FHTP) and that meet the no or low effective tax rate factor. It remains to be seen how harmful preferential regimes are defined.

The report underlines the necessity of a quick exchange of information. The exchange of information should not occur later than three months after the relevant information has been given to the Competent Authority of the country that has granted the ruling. The information on rulings will be exchanged between tax administrations only and will not be made public.

By limiting such exchanges to "taxpayer-specific rulings found to constitute harmful tax practices" (and not to all rulings, including Advance Pricing Agreements) the G20 is signaling that it wishes to constrain the volumes of information that must be exchanged in the future.

### 3. "We welcome progress being made on taxation of patent boxes"

The UK and German governments publishing a joint proposal designed to advance the negotiations on new rules for preferential IP regimes published just four days prior to the start of the Brisbane G20 meeting. It seeks to achieve a balance between maintaining countries' ability to offer tax benefits for the development of intellectual property and preventing the misuse of such benefits. The proposal takes forward the "nexus" approach outlined in the OECD's interim report on BEPS Action 5 in an effort to ensure substantial activity is undertaken in the jurisdiction offering the preferential IP regime, but seeks to reflect the commercial realities of research and development (R&D) investment by business.

It is expected that revised regimes will need to restrict the benefits by reference to the R&D undertaken by the entity, or outsourced to third parties, relative to its overall spend on global R&D. To compensate for the fact that under the nexus approach related-party outsourcing and acquisition costs would not constitute qualifying expenditure, a company would be able to uplift its qualifying expenditure by a set amount. The proposal suggests that this would be the lower of 30% of its qualifying expenditure and the actual expenditure on outsourcing and acquisition costs.

Under the proposed transitional arrangements, existing rules would apply to IP already within a regime until June 2016 and continue for IP within the regime at that date until June 2021. It is expected that countries, including the UK, would seek to implement revised OECD-compliant regimes in June 2016 to cover IP that is not grandfathered. Transitional rules are a key area identified in the joint announcement as requiring further work. The proposal also notes that the OECD Forum on Harmful Tax Practices (FHTP) should work to reach agreement by June 2015 on a practical and proportionate tracking and tracing approach that can be implemented by companies and tax authorities, which includes transitional mechanisms for IP from existing into new regimes and special rules for previous expenditure.

While this patent box proposal is noteworthy in its own right, the wider question will be whether it will effectively set the future ground rules for all IP regimes.

## Cairns Communiqué

In addition to these points in the Brisbane Communiqué, it is also interesting to look at the communiqué issued by Finance Ministers in September which seems to extend the G20 Tax Work in three areas.

### 1. "We welcome deeper engagement of developing countries in the BEPS Project to address their concerns."

The first new mandate was to broaden the inclusivity of the BEPS Project. This is a direct reaction (again, perhaps belatedly) to the growing economic and political influence of the emerging markets, not to mention their importance in helping define and agree upon a future cross-border tax system.

The mandate reads: *"We ask the OECD, IMF, UN, and World Bank Group to build on its current engagement* *with developing countries and develop a new structured dialogue process, with clear avenues for developing countries to work together and directly input in the G20/OECD Base Erosion and Profit Shifting project by the Leaders' Summit in November."*

That reference to "structural dialogue" is key. It refers to the fact that while the OECD has done much to try and bind in as many countries as possible in the BEPS Project, time and resources have been very limited. Although the OECD has conducted a series of regional meetings, there is a feeling that more can be done to draw in the wider perspectives of the lesser developed countries (LDCs) sooner rather than later. That's not to mention the fact that while India and China are both members of the G20, there may not be alignment between their interests, and those of LDCs.

The OECD formalized its strategy in the run up to the Brisbane G20 Leaders' summit. In a 12 November 2014 press release, the OECD set out a *new Strategy for Deepening Developing Country Engagement.*

According to the strategy paper, there will be three key areas of activity:

1. The OECD will invite more than 10 developing countries to join the BEPS Project, including Albania, Jamaica, Kenya, Peru, Philippines, Senegal and Tunisia to participate in meetings of the key BEPS decision-making body — the Committee on Fiscal Affairs (CFA) — and its technical working groups. Several other developing countries are expected to confirm their participation in the CFA or the technical working groups in the coming weeks.
2. The OECD will create five regionally organized networks of tax policy and administration officials. These five networks will coordinate an ongoing and more structured dialogue with a broader group of developing countries on BEPS issues. Building on the effective BEPS consultations that took place in 2013 and 2014, these networks will strengthen the involvement of developing countries in Asia, Africa, Central Europe and the Middle East, Latin America and the Caribbean, and Francophone countries.
3. The regional networks will play an important role in the development of toolkits needed to support the practical implementation of the BEPS measures and some of the priority issues for developing countries (such as tax incentives and transfer pricing comparable data) which are outside the BEPS Action Plan.

## 2. "We welcome further collaboration by our tax authorities on cross-border compliance activities."

The second extension refers to the role of tax administrations in BEPS. This collaboration will strengthen in the years ahead. On 24 October 2014, the OECD's Forum on Tax Administration (FTA) published a communiqué at the conclusion of their ninth meeting, which took place in Dublin, Ireland. The communiqué announced the creation of a new international platform called the Joint International Tax Shelter Information and Collaboration (JITSIC), formerly Joint International Tax Shelter Information Centre, whose objective will be to focus specifically on cross-border tax avoidance. This new body is open to all FTA members on a voluntary basis and will integrate the existing JITSIC cooperation among some national tax administrators into the larger FTA framework. The communiqué further announced agreement on a strategy for *"systematic and enhanced co-operation"* between tax administrations, based on existing legal instruments that will *"allow them to quickly understand and deal with global tax risks whenever and wherever they arise."* This refers to a permanent platform that will allow ongoing coordination of collaborative efforts between annual meetings.

## 3. "We ask the IMF to work with the OECD in consultation with other relevant international organizations, to analyze the implications of the tax policy mix and composition of government expenditure for growth outcomes."

The third dimension relates to tax and growth and is perhaps the most important new mandate since it looks at how tax systems can promote growth. It is worthwhile quoting from the communiqué under Issues for further action.

This is a good and belated recognition by Finance Ministers that the exchange of information, transparency and base erosion agenda, while all important in protecting the tax base and providing a level playing field, does little to address the broader issue of promoting growth.

The three-page background paper prepared by the IMF, "Growth Friendly Fiscal Policy," and which provides the basis from this new mandate, picks up the analysis and recommendations made by the OECD in its 2010 report on how to design pro-growth tax systems, namely:

1. The need to reduce corporate and personal income tax rates and compensate for the revenue loss by broadening the tax base(s).

2. The recognition that moving VAT systems towards a low rate that applies across a broad range of goods and services can stimulate growth.
3. The way in which a shift from direct taxes on income and profits to taxes on consumption and immovable property could increase growth.

These proposals did influence tax policy in many countries, but over the last two years we have seen some back peddling with some countries increasing some tax rates and also introducing new preferential tax regimes. Also, there has been little progress in revisiting exemptions and zero ratings under VAT regimes. Similarly, there has been a lack of political will to undertake a comprehensive review of the way the tax systems apply to land and buildings, not just traditional property taxes, but also other taxes which apply to property such as VAT and transaction taxes.

Hopefully, this initiative by the G20 will give a new political impetus to achieving growth enhancing structural changes in our tax systems, although any such recommendations will also have to address the issue of how such policies can be reconciled with the need to use tax systems to achieve a fairer distribution of the tax burden.

Closely linked to this third mandate is the statement that the IMF, OECD, UN and World Bank should *"prepare options for an efficient and effective use of tax incentives in low income countries,"* and report back on this mandate by 2015. In fact, all of these organizations have, for many years, worked on tax incentives and have a common position: countries should be cautious of using tax incentives to attract FDI and stimulate specific sectors (although well targeted incentives in the area of R&D are acknowledged as potentially useful, especially when targeted at small and medium sized enterprises). Despite this common position, very few countries have taken into account this advice and over the last decade we have seen a proliferation of tax incentives and specific preferential tax regimes, in what some NGOs have dubbed as a "race to the bottom" or a "disease," according to Pascal Saint-Amans, director of the OECD's Center for Tax Policy and Administration. Based upon the language used in the mandate, it is likely that the emphasis will not be on how to remove incentives altogether (all G20 countries use tax incentives extensively) but on how to improve their transparency, make them more accountable by incorporating them into the normal budgetary process and how to evaluate their impact. There is also no reason to believe that any policy recommendations from such a study will be directed at just low income countries as virtually all OECD countries also use incentives.

It is unclear how this new mandate will interact with Action 5 of the BEPS project which is intended to curb the harmful tax practices of countries. Clearly, there is a link since such regimes are by definition tax incentives, although the OECD 1998 Report on Harmful Tax Competition (which forms the starting point for BEPS Action 5) was limited to the financial and service sectors but the issues raised for FDI are similar. Also countries may be tempted to use these incentives, not just to attract FDI, but also to attract "footless" service and financial activities.

For business, the message is clear: it is important to follow closely not just developments in the BEPS agenda but also to understand how this Agenda links into the work of other International Organizations and other work carried out by the OECD. If business wants consistent rules to emerge from the global debate on taxation, more widespread monitoring and engagement will be necessary in the years ahead and ITIC provides a useful platform to achieve this.