Google, Amazon, Facebook, others to be affected in international tax reform

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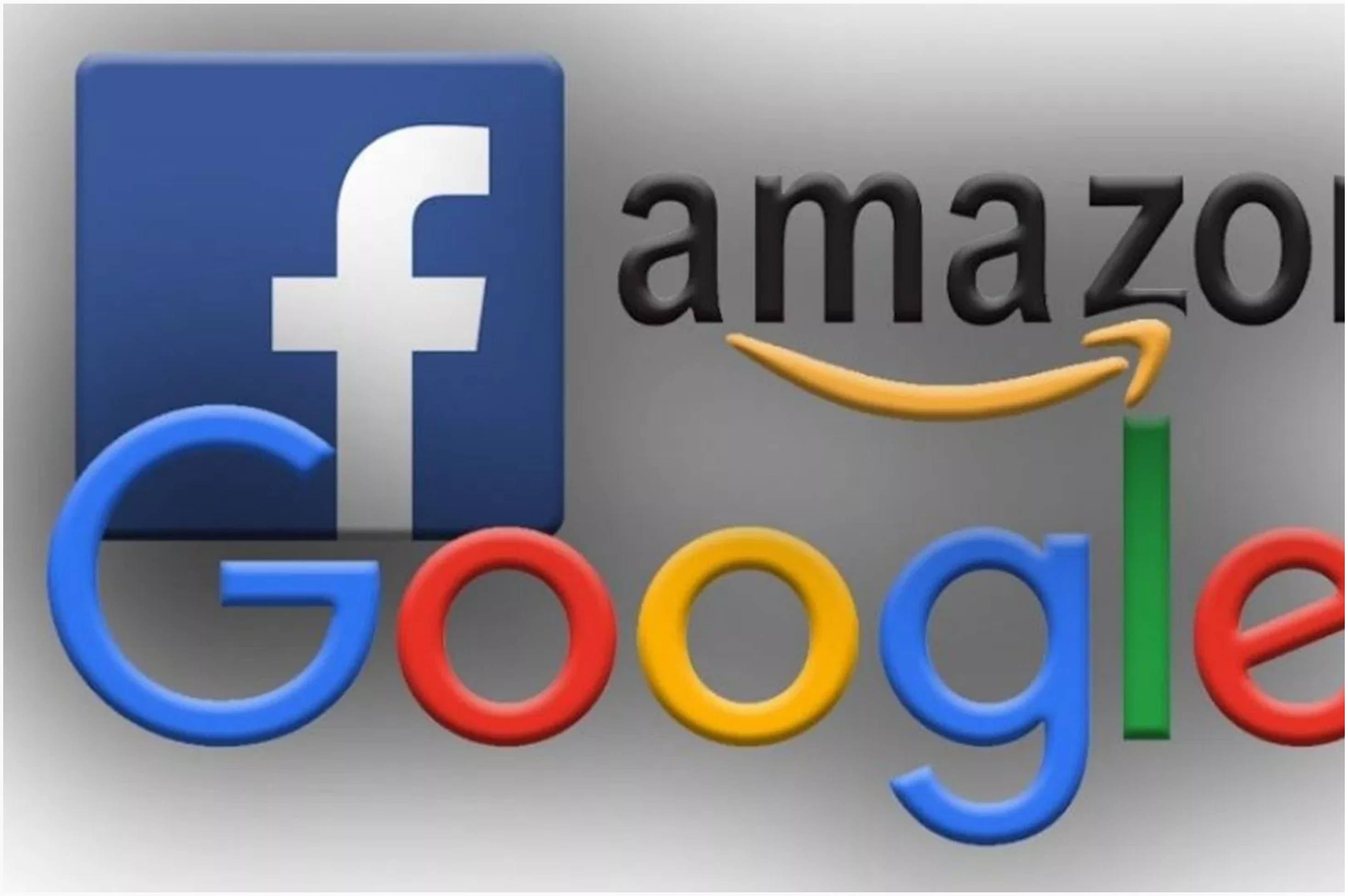

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Tax reforms that will see the likes of Google, Amazon, Facebook and Apple pay tax in the countries where they make their profits are some of the major topics discussed at the G20 Finance Ministers' meeting on June 8 and 9 in Fukuoka, Japan. They are expected to give a formal endorsement to the work plan adopted by 129 countries at the end of May in Paris.

On May 31, 2019, the Inclusive Framework on Base Erosion and Profit Shifting (BEPS) released a **Programme of work to develop a consensus to the tax challenges arising from the digitalisation of the economy**. This document proposes a menu of options to be further elaborated, ranging from small tweaks to the current dysfunctional system, to radical proposals which could result in significant reallocation of taxing rights and the introduction of a global minimum effective corporate tax rate.

The process of negotiations is now at a crossroads: it can continue to tinker at the edges with an inadequate system designed for the last century or deliver a remittances from FCT in 2011

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sustainable international tax architecture fit for purpose. The ICRICT believes this is the opportunity to move towards a system of international taxation that is simple, efficient and equitable.

Why is the current system failing?

The current system is based on the fiction of treating the various affiliates of multinationals as if they were independent of each other. This has encouraged multinationals to create complex tax-avoidance structures by forming hundreds of affiliates in convenient jurisdictions. These arrangements are conceptually straightforward: low profits are declared in high-tax jurisdictions, both in developed and developing countries, through the use, for instance, of limited risk structures, excessive debt and deductions for the right to use intangibles.

This system permits to multinationals to legally allocate their profits in low-tax jurisdictions or tax havens, and, consequently, pay almost zero tax. ICRICT commissioner Gabriel Zucman estimated that worldwide, **more than 40% of profits made by multinationals** are artificially moved to these territories. These problems have been exacerbated by the digitalisation of the economy because of the ability it gives companies to have a significant market share in an economy without physical presence.

Why this is the once in a lifetime opportunity to fix it?

In 2012, the G20 called on the Organization for Economic Cooperation and Development (OECD) to reform the international corporate tax system through the **Base Erosion and Profit Shifting** (BEPS) initiative. In 2015, a package of reforms was unveiled by the OECD, and it was afterwards open to non-G20 countries, including developing economies within the "Inclusive Framework", a body that now includes 129 member states from across the globe.

The BEPS project has resulted in helpful solutions for some of the most shocking tax avoidance mechanisms. But it has failed to address the core problem: companies are still allowed, through transfer pricing, to move their profits wherever they want and to take advantage of very low tax jurisdictions.

The failure to deal with transfer pricing by the OECD has led to a number of unilateral measures and this has opened up the path to a new round of negotiations, called BEPS 2.0, which are being conducted through the OECD Inclusive Framework.

What is this new OECD Inclusive Framework "workplan"?

The OECD/G20 work plan has identified two pillars for negotiations:

– Pillar 1: Reallocation of taxing rights to market jurisdiction

The OECD plans to allocate more taxing rights to countries where a corporation's products and services are consumed and where their digital users are resident. These reforms could mean many countries will for the first time be able to tax big corporations – including the big tech giants – based on the profits they generate in their country.

– Pillar 2: Introduction of a global minimum tax

The OECD wants to introduce a global minimum effective tax rate in order to ensure that all corporate profits are taxed at a minimum level. By signing up to minimum tax, all countries, including developing ones, will lose the right to offer tax incentives. This, however, should be seen as positive, as some studies have found that tax incentives are redundant in attracting investment, while revenue foregone from tax incentives also reduces opportunities for public spending on infrastructure, public services and welfare.

This also often results in multinationals playing different countries against each other in a race to the bottom. This damaging tax competition between countries is responsible for a collapse of corporate income tax across 94 jurisdictions from just over 28.6% in 2000 to 21.4% in 2018. The impact on public finances **is even more worrying in developing countries**, where corporate taxes are a key revenue source, representing on average 15.3% of all tax revenues in Africa and 15.4% in Latin America & the Caribbean, compared to 9% in the OECD.

What does ICRICT think about that?

As an independent Commission, we have urged governments **to move away from the existing transfer pricing system towards a unitary approach** to taxation of multinationals since the beginning of the BEPS process, preferably based on a system of **multi-factor global formulary apportionment**, **together with a global-effective minimum corporate tax rate.**

As such, we welcome the OECD/G20 Inclusive Framework work plan, especially the recognition in this document that “A growing number of jurisdictions are not content with the taxation outcomes produced by the current international tax system and that this dissatisfaction has created a political imperative to act.”

We believe this is the opportunity to move towards a principles-based system of international taxation that is simple, efficient and equitable.

Simple and efficient

Some of the proposals under Pillar I introduce formulaic elements to allocate the global profits of multinationals between countries. This is a positive step as it does away with the fiction of separate entity principle and recognizes the unitary nature of multinationals.

The move to introduce formulaic elements approaches will increase the transparency of the system and simplify its implementation and compliance.

Equitable

The ongoing negotiations under Pillar I will result in changes to the current allocation of taxing rights. The current system has systematically disadvantaged non-OECD member states, which are not home to the majority of world multinationals. A number of developing countries are members of the Inclusive Framework, so it is imperative that the outcome of the discussions on the reallocation of taxing rights reflect the demands of developing countries.

Developing countries are likely to gain from Pillar I whereas Pillar II will likely benefit rich countries – the home of MNEs. This is why it is important that a combined PILLAR I and PILLAR II solution is found.

The proposal from the International Group of 24 on International Monetary Affairs and Development (G-24) is the only proposal which has been tabled by a group of developing countries, with all other proposals tabled by OECD member states.

Opportunities to benefit at the expense of developing countries are inconsistent with the international community's efforts in financing for development and reaching Sustainable Development Goals, so Governments represented in the Inclusive Framework and the OECD cannot approach this opportunity for reaching a consensus without due consideration for the demands tabled by developing countries and the distributional effects of agreed outcomes.

What are the next steps?

The G20 Finance Ministers are expected to give a formal Greenlight to the work programme during their meeting in Japan. The OECD aims to have an outline of the final agreement in January 2020 for approval by G20 Heads of State at a Summit in Saudi Arabia in November 2020.

ABOUT ICRICT:

The Independent Commission for the Reform of International Corporate Taxation aims to promote the international corporate tax reform debate through a wider and more inclusive discussion of international tax rules than is possible through any other existing forum; to consider reforms from a perspective of public interest rather than national advantage; and to seek fair, effective and sustainable tax solutions for development.

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