Chapter 4

Multilateral initiatives to address avoidance and aggressive minimisation

Overview of the multilateral tax reform initiative

4.1 The opportunities for aggressive tax minimisation and avoidance have grown commensurately as the relative importance of global trade and multinational corporations has risen. According to the OECD, WTO and World Bank Group, over 70 per cent of global trade today is in intermediate goods, services and capital goods.[1] Indeed, the OECD considers that:

> The growth of MNEs [multinational enterprises] presents increasingly complex taxation issues for both tax administrators and the MNEs themselves since separate country rules for the taxation of MNEs cannot be viewed in isolation but must be addressed in a broad institutional context.[2]

4.2 The international tax architecture was developed over 50 years ago and has been a critical driver of economic growth globally by providing the certainty and stability needed to encourage long-term international trade and investment.[3] The OECD has led the development of these international tax standards through:

- promulgating the rules guiding the standards, namely the OECD Model Tax Convention and the Transfer Pricing Guidelines;
- developing instruments to support cross-border cooperation, such as the Model Tax Information Exchange Agreement and the multilateral Convention on Mutual Administrative Assistance in Tax Matters; and
- combating tax evasion by establishing and promoting the international standards on Exchange of Information 'on request' (EOI) and, more recently, the Standard on Automatic Exchange of Information (AEOI).[4]

4.3 While the OECD's efforts in tax reform were originally focused on eliminating double taxation (that is, paying tax in both the source and residence countries) arising from cross border investment, more recently the converse issue of double non-taxation (that is, not paying tax in either the source or residence countries) has emerged. As Mr Pascal Saint-Amans from the Centre of Tax Policy and Administration, OECD, described:

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1 *Global Value Chains: Challenges, Opportunities, and Implications for Policy*, Report prepared for submission to the G20 Trade Ministers Meeting, Sydney, Australia, 19 July 2014, p. 7.

2 OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrators*, July 2010, p. 17.

3 Business Council of Australia, *Submission 87*, p. 12.

4 OECD, *Submission 85*, p. 1.

> …in many countries there have been growing concern[s] about double non-taxation, seeing how companies in a globalised environment have been able to legally—or, most often, legally—plan their tax affairs in quite an aggressive way which has reduced their tax burden to something which is very different from the nominal tax rates in different countries. This is a worldwide phenomenon that we in the OECD have quantified as base erosion and profit shifting.[5]

4.4 As governments have become increasingly aware that international tax laws have not kept pace with the increased interconnectedness and digitisation of the modern global economy, there has been a more concerted effort to work collaboratively to progress tax integrity reforms. According to the Business Council of Australia:

> International tax laws are either not robust enough or mismatches have emerged, and there has been a growing importance of different types of assets, such as intangibles (e.g. patents and trademarks). There is also genuine difficulty and complexity in determining where profits are sourced—reasonable minds can disagree.[6]

4.5 More broadly, the OECD outlined the reasons why tax concerns are at the forefront of the international political agenda:

> In recent years, the onset of the global financial crisis and slowing economic growth was coupled with perceptions of rising inequality and a lack of fairness. Society was asked to bear the burdens of higher taxes and reduced public spending, while there was a growing awareness that some multinational businesses paid very low levels of taxation on their global profits, including some that received taxpayer-funded bailouts. In this environment, the demand to reform the international tax system and the importance of the OECD's work on tax has reached the top of the international political agenda.[7]

4.6 Reflecting this ongoing concern, the G20 commissioned the OECD to undertake a comprehensive review of the international tax architecture and develop policy proposals to modernise global tax laws ensuring they remain fit-for-purpose and support continued trade, investment and growth.[8]

4.7 The OECD-G20 Base Erosion and Profit Shifting (BEPS) Project was launched in 2013 after an OECD report, *Addressing Base Erosion and Profit Shifting*, outlined global developments that affect corporate tax matters. The report also identified the key principles that should underpin the taxation of cross-border activities, as well as the BEPS opportunities that these principles may create.[9]

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5 *Committee Hansard*, 9 April 2015, p. 59.

6 *Submission 87*, p. 12.

7 OECD, *Submission 85*, p. 1.

8 Business Council of Australia, *Submission 87*, p. 12.

9 OECD, *Submission 85*, p. 1.

4.8 The OECD describes the BEPS Project as:

> …aimed at reforming international tax rules to realign taxation of profits with the underlying economic activities and value creation. This means addressing the loopholes and mismatches in the rules and between domestic tax systems which allow multinationals, legally in most cases, to move profits to low or no tax jurisdictions where little real economic activity takes place.[10]

4.9 The project initially brought together 44 countries—all 34 OECD countries and 10 BEPS associates (the non-OECD G20 countries, and Columbia and Latvia). Since January 2015, a further group of countries have been integrated into the project bringing the total to 62 countries that are involved in meetings of the decision making body or technical working groups. Together, these countries represent over 90 per cent of the world economy.[11]

4.10 Australia has been heavily involved in the BEPS Project through hosting the G20 meeting in 2014 and ongoing engagement by the ATO and Treasury.[12] Mr Economics Legislation Committee, Saint-Amans noted that:

> As chair of the G20, Australia has been a mentor of that [BEPS] project. Your Prime Minister, your Treasurer, were instrumental in putting very high on the agenda the BEPS discussions during the G20…Australia has been absolutely involved in all working groups.[13]

4.11 Professor Kerrie Sadiq highlighted the leadership role that Australia has and will continue to have in developing and implementing the BEPS actions:

> …it will be a case of sovereign nations adopting the recommendations out of the OECD BEPS project and countries like Australia entering into multilateral convention, altering tax incentives or enacting domestic legislation. This is where Australia must be proactive in adopting OECD BEPS recommendations and has the opportunity to show leadership within the region.[14]

The BEPS Action Plan

4.12 In 2013, the OECD released a comprehensive 15 point action plan to address the most important elements contributing to base erosion and profit shifting (BEPS). The areas covered by the action plan are intended to:

1. address the challenges of the digital economy;
2. neutralise the effects of hybrid mismatch arrangements;
3. strengthen rules on Controlled Foreign Companies (CFCs);

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10 *Submission 85*, p. 1.

11 OECD, *Submission 85*, p. 2.

12 Mr Rob Heferen, *Committee Hansard*, 9 April 2015, p. 18.

13 *Committee Hansard*, 9 April 2015, p. 61.

14 *Committee Hansard*, 8 April 2015, p. 9.

4. limit base erosion via interest deductions and other financial payments;
5. counter harmful tax practices more effectively, taking into account transparency and substance;
6. prevent tax treaty abuse;
7. prevent the artificial avoidance of permanent establishment (PE) status;
8. assure that transfer pricing outcomes are in line with value creation—intangibles;
9. assure that transfer pricing outcomes are in line with value creation—risks and capital;
10. assure that transfer pricing outcomes are in line with value creation—other high-risk transactions;
11. establish methodologies to collect and analyse data on BEPS and the actions to address BEPS;
12. require taxpayers to disclose their aggressive tax planning arrangements;
13. re-examine transfer pricing documentation;
14. make dispute resolution mechanisms more effective; and
15. develop a multilateral instrument capable of implementing the tax treaty-related BEPS measures.[15]

4.13 The plan is designed to ensure the coherence of corporate tax systems in a cross-border environment, introduce substance requirements in the area of tax treaties and transfer pricing, and ensure transparency while promoting certainty and predictability.[16] It is a comprehensive plan for international tax reform that aims to bring countries together so they will be more efficient in addressing aggressive tax planning, rather than taking unilateral measures that might be more disruptive and increase the risk of double taxation.[17]

Progress so far

4.14 The release of the policy proposals is staged over 2 years—known as the 2014 deliverables and 2015 deliverables. The 2014 deliverables were released at the G20 Finance Ministers meeting in September 2014 and cover seven of the action areas. The key outcomes of this first stage, with implementation of the relevant measures by national governments, are:

- hybrid mismatches will be neutralised (Action 2);
- an agreed minimum standard to put an end to treaty shopping and other forms of treaty abuse (Action 6);

15 OECD, *Submission 85*, p. 2.

16 OECD, *Submission 85*, p. 2.

17 Mr Pascal Saint-Amans, *Committee Hansard*, 9 April 2015, p. 59.

- abuse of transfer pricing rules in the key area of intangibles will be minimised (Action 8); and,
- better transparency for tax administrations and more global consistency for taxpayers through improved transfer pricing documentation and a template for country-by-country reporting (Action 13).[18]

4.15 In addition, OCED members and BEPS associate countries agreed that negotiation on implementing tax treaty-related BEPS measures through a multilateral instrument would begin by mid-2015 (Action 15).[19]

4.16 Final agreement on the approach to fight harmful tax practices through intellectual property regimes was reached in January 2015 (Action 5).[20]

4.17 The 2014 deliverables also included a report setting out a common understanding of the tax challenges raised by the digital economy, which will form the basis for extending the work in this area of the economy where BEPS practices can be exacerbated (Action 1).[21]

Work to be completed

4.18 The 2015 deliverables will report on actions that were not addressed in the 2014 deliverables. Accordingly, eight discussion drafts have been issued for public comment and it is anticipated that, despite the tight timelines, all of the 2015 deliverables will be presented as soft law instruments that countries will then be invited to translate into their domestic and legal frameworks as necessary.[22]

4.19 The full package of BEPS measures, agreed by consensus of the OECD members and BEPS associates, will be presented to the G20 Finance Ministers in October 2015, and, in turn, to the G20 Leaders at their meeting in November 2015.[23]

Will multilateral tax reform through the BEPS Project be effective?

4.20 The OECD's ambitious work program to develop multilateral initiatives to address base erosion and profit shifting is generally supported by stakeholders. However, concerns have been raised about: the willingness of countries to support and implement reform; the accelerated timeframe of the plan's development; and the overall effectiveness of the measures proposed.[24]

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18 OECD, *Submission 85*, p. 3.

19 OECD, *Submission 85*, p. 3.

20 OECD, *Submission 85*, p. 3.

21 OECD, *Submission 85*, p. 3.

22 Mr Pascal Saint-Amans, *Committee Hansard*, 9 April 2015, p. 60.

23 OECD, *Submission 85*, p. 3.

24 See, for example, evidence provided by Professor Richard Vann, Professor Kerrie Sadiq and Associate Professor Antony Ting, *Committee Hansard*, 8 April 2015, pp. 9–18.

General support for multilateral tax reform

4.21 The intent and process of the OECD's work towards international tax reform has been strongly supported by government and stakeholders in all participating countries. This initiative has also been guided and supported by a broad range of stakeholders. As the OECD reports:

> Broad stakeholder engagement has been an important factor guiding the BEPS work since the beginning, through the release of discussion drafts, public consultations, and regular live webcasts watched by more than 26 000 people to date. Business, civil society, trade unions and academics have all made significant contributions to the Project and are shaping the solutions to ensure they are appropriately nuanced—striking a balance that addresses the need for effective measures and the risk of excessive compliance burdens.[25]

4.22 Many stakeholders outlined and emphasised the benefits of multilateral action. In the view of Mr Saint-Amans:

> …multilateral action is much more fit for purpose than uncoordinated unilateral actions, for a couple of reasons. One is that unilateral action is much less efficient and effective than multilateral approaches. If you act on your own, it is going to be more difficult to fix the issues than if all the countries act together or all the countries recognise that a number of actions are fit for purpose…
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> The second element is about keeping the balance between putting an end to double non-taxation—stateless income…—and keeping away from double taxation. The risk of unilateral action is about creating risks for double taxation.[26]

4.23 The Business Council of Australia commented that coordinated multilateral action is important to support trade and investment:

> The OECD's BEPS process is of great importance to Australia as a medium-sized open economy that is heavily dependent on trade and foreign investment.[27]

4.24 The majority of companies that made submissions to the inquiry also offered support for the BEPS process. For example, Transurban submitted that it:

> …encourages Australia to continue its significant involvement with the G20 and the OECD Base Erosion and Profit Shifting project. In particular, Transurban supports this collaboration because it will help ensure that any cross-border tax measures are addressed in a coordinated, multilateral manner with due regard to the economic objectives of the various jurisdictions involved.[28]

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25 *Submission 85*, p. 2.

26 *Committee Hansard*, 9 April 2015, pp. 60–61.

27 *Submission 87*, p. 4.

28 *Submission 55*, p. 7.

4.25 A number of non-government organisations, charities and unions were cautiously supportive of the BEPS initiative. For example, Action Aid Australia submitted that:

> ActionAid Australia recognises the development of the Base Erosion and Profit Shifting (BEPS) process by the G20 and the OECD, to the extent that there is now an existence of some actionable process in place to address the issue of corporate tax avoidance.[29]

4.26 Reflecting the views of many participants to the inquiry, Professor Kerrie Sadiq was optimistic that:

> The work of the OECD BEPS project will hopefully give countries the tools they need to ensure that profits are taxed where the economic activities generating profits are performed and where value is created.[30]

4.27 Treasury outlined the importance of taking a measured approach in relation to the implementation of the BEPS program reforms:

> Any changes need to be well considered to ensure they do not unnecessarily affect legitimate business activity…The risks of overreach are high and Australia simply does not have the luxury of enacting laws that, on the face of them, attempt to deal with tax avoidance but in substance provide legitimate value-creating activity from taking place.[31]

4.28 Similarly, the Tax Institute, CPA Australia, and the Corporate Tax Association, supported the OECD's work but urged the committee not to act in haste and pre-empt the outcomes and impacts of the BEPS process.[32]

4.29 Despite Australia's cautious approach to introducing the BEPS measures so far, the government has announced a number of measures to commence implementation of four of the key actions arising from the 2014 deliverables—Country-by-Country reporting; treaty abuse rules; anti-hybrids rules; and, harmful tax practices and exchange of rulings.[33] The potential role of Country-by-Country reporting in assisting tax administrators is explored in chapter 6.

Concerns about the BEPS initiative

4.30 While most stakeholders agree that it is worth waiting for the full package of BEPS deliverables to be presented and for countries to take coordinated action in line with the action plan, many also indicated that it might be worthwhile to explore unilateral initiatives in parallel with the development of the BEPS measures.

4.31 Some stakeholders were concerned that countries would thwart the implementation of the BEPS program by refusing to implement the agreed action

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29 *Submission 67*, p. [2].

30 *Committee Hansard*, 8 April 2015, p. 9.

31 Mr Robert Heferen, *Committee Hansard*, 9 April 2015, p. 18.

32 *Submission 33*, p. 5; *Submission 73*, p. [2]; *Submission 59*, p. 13.

33 Australian Government, *Fairness in Tax and Benefits*, Budget 2015–16, p. 8.

plans. Professor Richard Vann noted the risks associated with relying on countries to implement multilateral actions and that the previous attempt to undertake significant international tax reform through the OECD Harmful Tax Competition project was limited when the US stopped supporting it in 2001.[34]

4.32 In this regard, it should be noted that, in contrast to previous attempts at international tax reform, the full package of measures resulting from the BEPS project will include minimum standards to which countries should commit. As described by Mr Saint-Amans:

> What we are going to present are soft law instruments that will include minimum standards that countries will have committed to, and then countries will be invited to translate these into their domestic legal and regulatory frameworks as necessary.[35]

4.33 Associate Professor Antony Ting contended that resistance to transfer pricing reforms may be indicative of a larger problem:

> As transfer pricing is often at the core of most BEPS structures, the ideal solution is to fix the transfer-pricing rules on an international consensus basis. The OECD BEPS project has been trying to do that since 2013; however, the experience so far is not encouraging. Even modest proposals to reform the current transfer-pricing rules have been subject to fears and objections from business and tax professionals.
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> The fact that some countries do not seem to be wholeheartedly supporting that BEPS project worsens the situation. Research has revealed that the US has been knowingly facilitating these multinationals to avoid foreign taxes. Furthermore, the objective of this involvement in the BEPS project seems to be to undermine the project. If we accept this reality, what can Australia do? It may be worthwhile to consider second-best solutions.[36]

4.34 Responding to concerns that countries may try to frustrate the implementation of BEPS, Mr Saint-Amans highlighted that:

> …if one country were to block the others from moving ahead, as countries are sovereign, what is going to happen is that countries will take unilateral measures, which will globally be detrimental to the tax affairs of the companies of the other countries. So it is a cooperative game.[37]

4.35 Even though the full set of BEPS deliverables will be presented in October 2015, it may take some time for these actions to be adopted and translated into law by participating countries. In the view of the Business Council of Australia:

> The BEPS project will take time due to the complexity and multilateral approach, but also in part because each country confronts the challenge

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34 *Committee Hansard*, 8 April 2015, p. 10.

35 *Committee Hansard*, 9 April 2015, p. 60.

36 *Committee Hansard*, 8 April 2015, p. 11.

37 *Committee Hansard*, 9 April 2015, p. 62.

> from a different starting point. This includes the sophistication of existing domestic tax systems, level of compliance, and structure of economies.[38]

4.36 While supporting the intent of the BEPS program, some stakeholders implored the committee to consider the national interest. For example, Transurban contended that Australian companies should not be disadvantaged:

> …Australia's policy on these matters [cross-border tax measures] should always be to not disadvantage complying Australian companies and to ensure that the tax environment promotes economic growth and productive investment.[39]

4.37 Although the accelerated nature of the BEPS process seeks to ameliorate the need for countries to take unilateral action, it has the potential to result in unintended consequences and actions that were not foreseen during development. For example, the Uniting Church of Australia, Synod of Victoria and Tasmania, highlighted an apparent shift in aim of the project early on:

> The Synod shares the concern of the BEPS Monitoring Group that the OECD in the BEPS Action Plan has drifted from the G20 aim of 'Profits should be taxed where the economic activities deriving the profits are performed and where value is created', to the elimination of 'double non-taxation'. The shift is important as the OECD goal can be achieved by simply ensuring all profits are taxed somewhere, but that somewhere would not have to be in the place where the economic activities deriving the profits are performed and where value is created.[40]

4.38 This shift in focus may lead to actions that are not in the national interest of some nations and make it even more important for countries to have the option of taking unilateral action so they are not disadvantaged by the proposed reforms.

Committee view

4.39 The committee considers that the efforts of the OECD in addressing problems associated with base erosion and profit shifting are worthwhile. The Australian Government should continue to support fully the development and timely implementation of the actions that arise from this initiative.

4.40 The committee appreciates the risks to Australia's corporate revenue base posed by the current international tax system and the efforts of the OECD to address issues related to base erosion and profit shifting through the BEPS project. It acknowledges that this project will not be completed until later in 2015 and is encouraged by progress to date.

4.41 Accordingly, the committee considers that it is appropriate for the Australian Government to continue to support and contribute to the BEPS project and other initiatives by the OECD (such as automatic exchange of information) so that

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38 *Submission 87*, p. 13.

39 *Submission 55*, p. 7.

40 *Submission 74*, p. 170.

coordinated, multilateral action on international tax reform can help restore the integrity of international tax systems and enhance Australia's revenue base.

4.42 However, in the case that a coordinated response fails to materialise in an acceptable timeframe, the Australian Government should reserve the right to act unilaterally to address identified shortcomings in the taxation of multinational operations.

Recommendation 2

4.43 The committee recommends that the Australian Government continue to take a leadership role in finalising and implementing the efforts of the OECD in addressing problems associated with base erosion and profit shifting. However, the committee also considers that international collaboration should not prevent the Australian Government from taking unilateral action.