Why BEPS?

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BEPS is the acronym for the OECD's initiative on "base erosion and profit shifting"

- A brief chronology would be
  - At the June 2012 Meeting of the G-20 Finance Ministers in Mexico – "We reiterate the need to prevent base erosion and profit shifting and will follow with attention the ongoing work of the OECD in this area"
  - Followed in December of 2012 by the OECD study – Addressing Base Erosion and Profit Shifting – an 87 page report for the G-20 on the OECD's progress
    - "What is at stake is the integrity of the corporate income tax"
    - "There is an urgent need to deal with this issue and the OECD is committed to provide an innovative and timely response…."
    - A "comprehensive action plan should be developed quickly"

A brief chronology — Continued

- February 2013 – The OECD study submitted, as promised, to the G-20 Finance Ministers at their meeting in Moscow –
  - "…we welcome the OECD report on addressing base erosion and profit shifting…and look forward to the comprehensive action plan the OECD will present to us in July"
  - Followed by statements from the UK, French and German finance ministers about the "exploitation" by multinational enterprises of transfer pricing and treaty rules
- July 2013 OECD, <u>Action Plan on Base Erosion and Profit Shifting</u> – 15 "action" items – endorsed by the G-20 at its meeting in St. Petersburg in September of 2013
  - Then, work on "deliverables", *i.e.*, on the implementation of the 15 action items

Why BEPS?

- A revenue "grab"?
  - Wall Street Journal – July 23, 2013 – "A Global Revenue Grab"
    - "After five years of failing to spur a robust economic recovery through spending and tax hikes, the world's richest countries have hit upon a new idea that looks a lot like the old: International coordination to raise taxes on business,"
    - "BEPS is "bureaucratese for not paying as much tax as government wishes you did"
- An attack on the US? Or a jobs "grab"?
  - Boidman & Kandev – BEPS: The OECD Discovers America? – "An experienced tax professional is left wondering: Has the OECD just discovered America? Has it just found out about [the] most standard cross-border tax planning…? Of course that cannot be so…"

Why BEPS?

- Progressive Policy Institute – June 2015 – "The BEPS Effect: New International Tax Rules Could Kill US Jobs"
- Paul Caron – June 2015 – New York Times – Obama's Corporate Tax Blunder – BEPS is a Loser (in Jobs, Revenue) for the United States – "unless Congress acts quickly to reform the ossified American corporate tax system, the BEPS rules have the potential to turn into an enormous job-and-revenue grab by Europe, and an enormous loss of jobs and revenues by the United States…"
- Antony Ting – 2014 – "The analysis [of Apple] reveals that the US Government has knowingly facilitated the avoidance of foreign income tax by its multinational enterprises…, thus creating double non-taxation"

Why BEPS?

Continued

- Just speeding up what the OECD has been doing for years (beginning with its 1998 report on tax evasion and avoidance and harmful tax competition)?
  - OECD – BEPS “refers to tax planning strategies that exploit gaps and mismatches in tax rules …resulting in little or no overall corporate tax being paid”
  - And – “The OECD has been providing solutions to…aggressive tax planning for years. The debate over BEPS has now reached the highest political levels in many OECD and non-OECD countries”
  - And “The OECD does not see BEPS as a problem created by one or more specific companies. ….. the issue lies with the tax rules themselves. Business cannot be faulted for using the rules that governments have put in place. It is therefore governments’ responsibility to revise the rules or introduce new rules”

Why BEPS?

Continued

- Public outrage?
  - Yves Brauner in "What the BEPS?" –
    - "Unprecedented attention to aggressive international tax planning has shaken the earth under the most powerful players in the world of international tax policy design"
    - And "The media exposure of what Bloomberg's calls "The Great Corporate Tax Dodge," combined with the ever growing discontent of civil society with the magnitude of contribution of the largest multinational enterprises to the society with which they operate has recently forced the politicians to take action"
    - And "…the substantive rules of the international tax regime were beside the point; it was the media exposure of these tax-planning schemes that mattered"

Why BEPS?

Continued

- Just repairing the existing system?
  - Richard Vann – "at the centre of the concern of BEPS is the recognition that many multinationals, especially those operating in the digital economy, are paying very little corporate income tax.... The main objective of the whole BEPS exercise is thus the protection and restoration of the international corporate tax base...."
- Other explanations?
- All of the above?

Focus on US multinationals

- No question that the US focus on its multinationals had an impact – Apple, Google, GE, Starbucks, Amazon, etc. -- A little history
  - July 2010 – Staff of the Joint Committee on Taxation, "Present Law and Background Related to Possible Income Shifting and Transfer Pricing", July 20, 2010, JCX-37-10.
    - Considered 6 unnamed US corporations (Alpha, Bravo, etc.) based on their public filings – widely believed to include Cisco and Apple, at least
  - The press, including in particular reporting by Bloomberg on Google's "Double Irish Dutch Sandwich" and reporting by Reuters on Starbucks UK, and Apple
  - Academics, including in particular Ed Kleinbard's articles on "Stateless Income"

“Naming and shaming”

- “Naming and shaming”?
  - Hearings before the Permanent Subcommittee on Investigations of the US Senate’s Homeland Security and Government Affairs Committee
    - September 2012 – Microsoft and Hewlett-Packard
    - May 2013 – Apple
    - March 2014 – Caterpillar (after a whistleblower’s suit)
  - Other countries jumped in (although not focusing on their own multinationals)
    - November 2012 hearings on Google, Starbucks and Amazon before the UK Parliament’s Public Accounts Committee
    - April 2015 hearings in the Australian Senate on Google, Microsoft, Apple

And then, "State Aid"

- Is tax avoidance the "flip side" of harmful tax competition? If so, no surprise that the issue of "State Aid" emerged – special deals for some taxpayers, not available to others, which are prohibited by the EU treaty
  - Starting in June 2013, the EU begins to look into tax ruling practices --
    - First, in a few countries, including Luxembourg, the UK, Ireland and the Netherlands
    - Then more broadly in a larger number of member states, including Belgium, France, Germany, Italy and Spain

* Ault, Schoen, and Shay

And then, "State Aid"

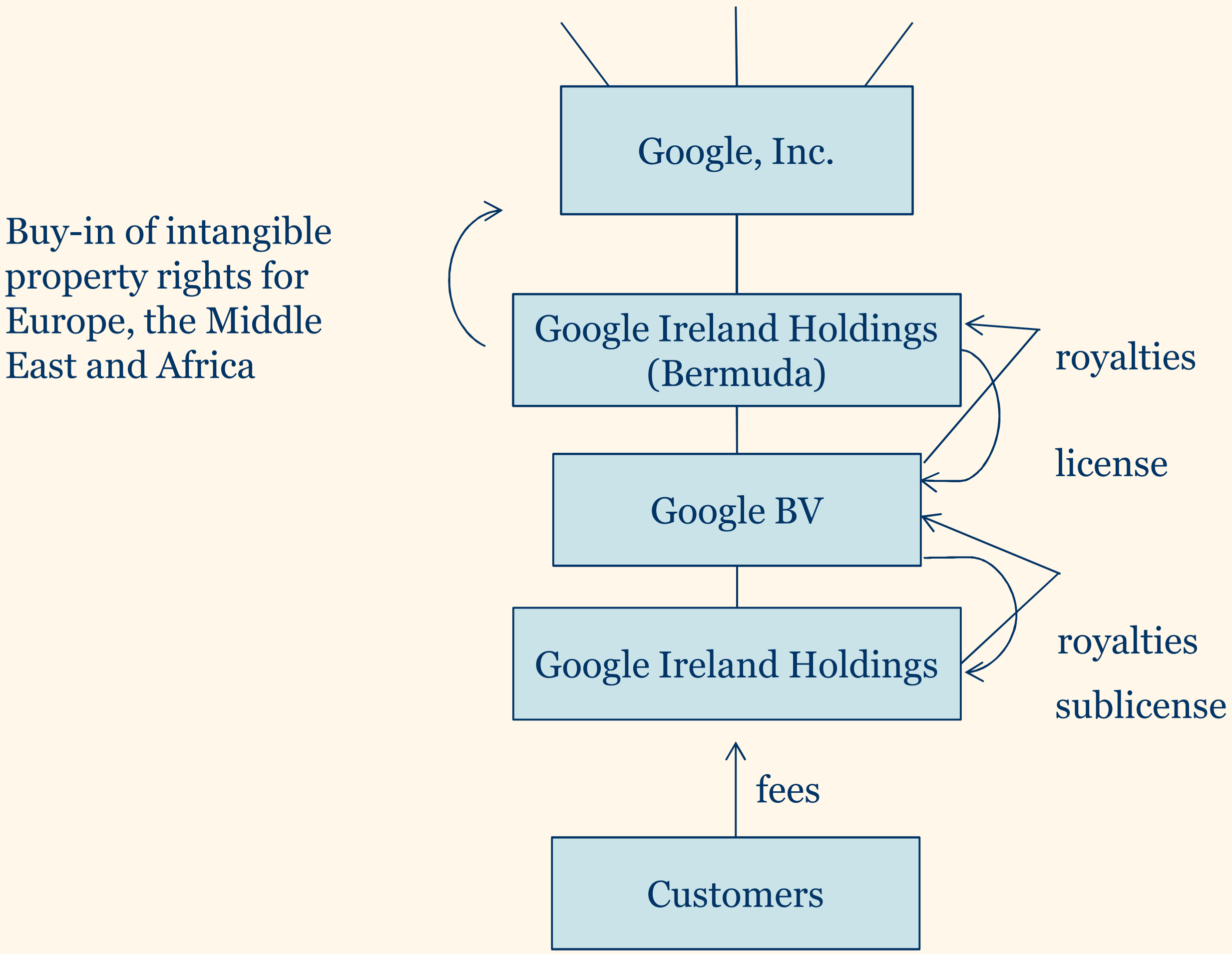
Continued

- Then, EU opens investigations into specific rulings issued by Ireland (to Apple), Luxembourg (to Amazon, Fiat, McDonald's – allegedly), and the Netherlands (to Starbucks)
- And the leak and publication in November 2014 of more than 300 rulings issued to taxpayers by Luxembourg

Google's Foreign Operations

- Google's foreign operations
  - Irish incorporated but Bermuda resident subsidiary ("Google Holdings") buys intellectual property rights for Europe, the Middle East and Africa from the parent – shortly prior to the parent's public offering
  - Bermuda resident subsidiary in turn licenses its Dutch subsidiary ("Google BV") which in turn licenses its Irish subsidiary ("Google Ireland") which in turn licenses customers
  - No CFC income -- Because of the check the box regulations, the US treats the income from customers as derived directly by the Bermuda resident subsidiary from the active conduct of a business
  - Irish tax on license fees (nominally, 12.5%) is reduced by royalties paid to its Dutch parent to less than 1% of revenues, Dutch tax on income is reduced by royalties paid to the Bermuda resident parent of 98.8% of its revenues, and Dutch treaty eliminates withholding tax because its parent is Irish incorporated. No tax in Bermuda

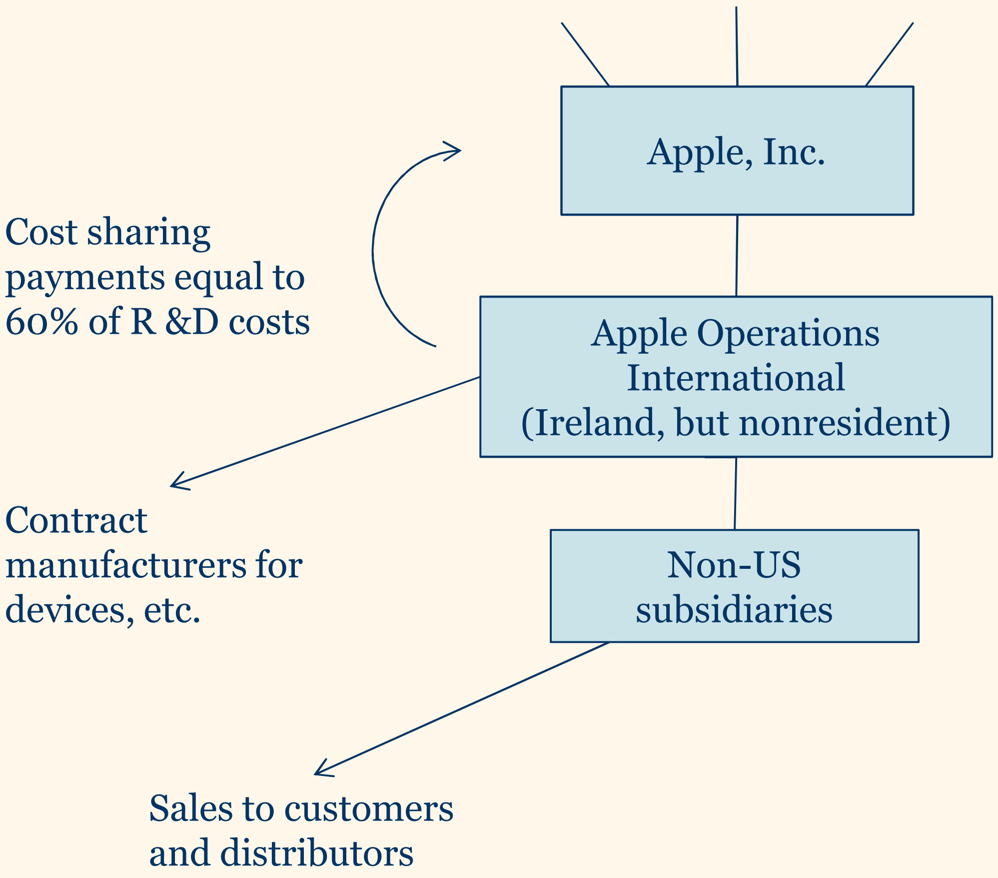
Google's Foreign Operations



Apple's Foreign Operations

- Apple's foreign operations
  - An Irish subsidiary ("Apple Operations International"), which owns the foreign rights to Apple's intellectual property, and in turn has foreign subsidiaries, all treated for US tax purposes as branches of the Irish subsidiary
  - The Irish subsidiary is not resident in Ireland because not managed and controlled there – thus, a specially negotiated 2% rate of Irish tax, not the statutory 12.5% rate
  - Irish subsidiary through a contract manufacturer in China manufactures computers, phones and related devices, and then resells the devices to distributors and customers at a mark up
    - No "controlled foreign corporation" income in the US because the Irish subsidiary is viewed as deriving its income from manufacturing and selling

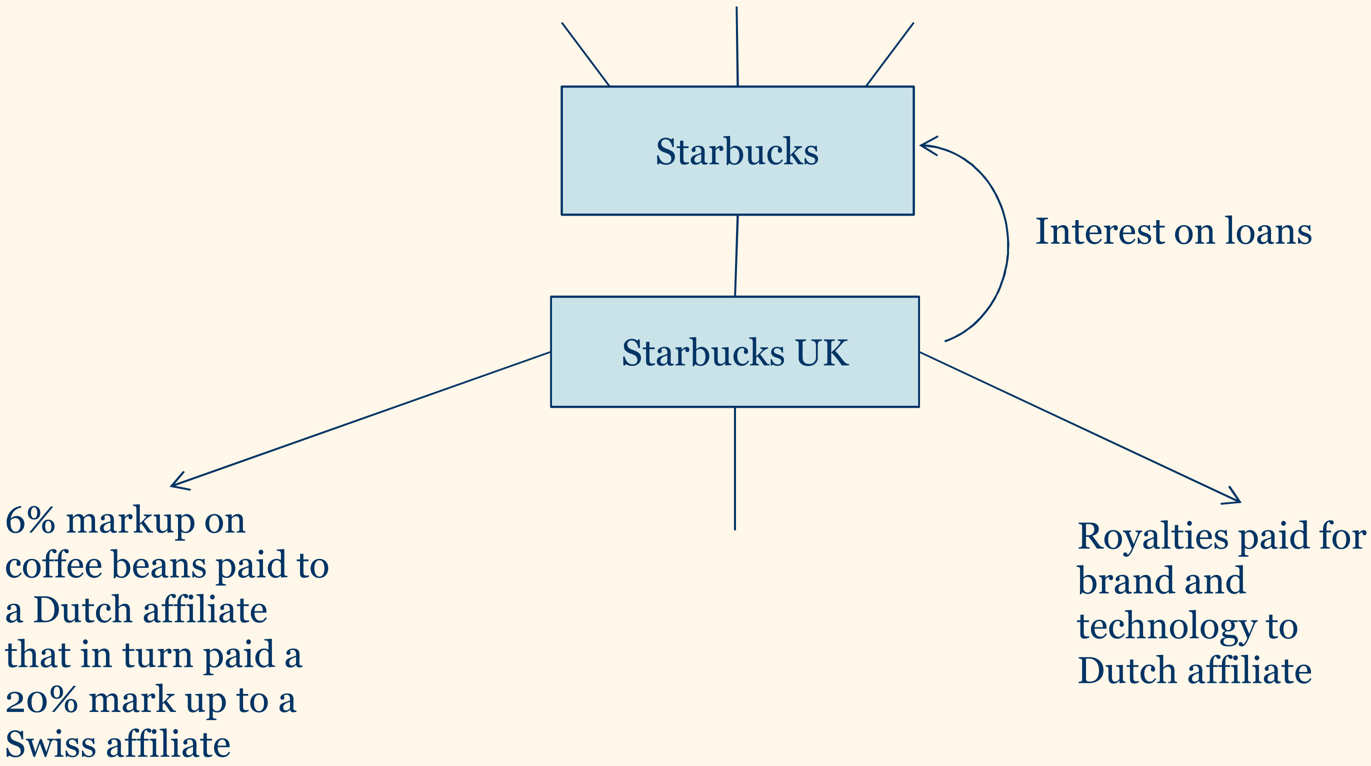
Apple's Foreign Operations



Starbuck's UK Operations

- Starbucks' UK operations
  - Starbucks UK had tax losses for 14 out of the first 15 years it carried on business in the UK, although it had a 31% market share
  - Largely because of
    - 20% mark-up paid a Dutch affiliate to a Swiss affiliate for green coffee beans, and a further 6% markup paid by Starbucks UK to the Dutch affiliate for roasted coffee beans
      - Excluded from the US controlled foreign corporation rules because of an exception for agricultural commodities
    - Royalties and license fees of 4.7-6% of sales paid to a Dutch affiliate for the use of its proprietary coffee roasting style, the brand and name
      - Also excluded from "controlled foreign corporation" income
    - Interest paid to the US parent on debt financing

Starbucks' UK Operations



What are the "Actions"

1. Address the challenges of the digital economy
2. Neutralize the effects of hybrid mismatch arrangements
3. Strengthen CFC rules
4. Limit base erosion via interest deductions and other financial payments
5. Counter harmful tax practices more effectively
6. Prevent Treaty abuse
7. Prevent the artificial avoidance of PE status
8. Assure that transfer pricing outcomes are in line with value creation: Intangibles and hard-to-value intangibles

What are the "Actions"

Continued

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 analyze date on BEPS and the actions to address it
12. Require taxpayers to disclose their aggressive tax planning arrangements
13. Transfer pricing documentation and a country-by-country reporting template
14. Make dispute resolution mechanisms more effective
15. Develop a multilateral instrument