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What BEPS Tax Project is (really) all about?

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"*You never want a serious crisis to go to waste*", Rahm Emanuel, Chicago Mayor (and former Obama White House chief-of-staff)

Fundamental reforms are always controversial and the G20/OECD hard-pressed Base Erosion Profit Shifting project is no exception to this rule. They shake with presumed principles, they provoke a wide debate, they alarm businesses if they are required to change their status-quo, they bond special interest groups behind certain expectations and they are ultimately only taken seriously when there is strong political support behind them.

There is a confluence of factors that impact the reform process and its outcomes and regardless of any concessions or compromises achieved there will be always vocal discontents as well as less verbal supporters.

Understanding in a geopolitical way the tax policy issues underlying the BEPS project is therefore critical to comprehend its drivers, constraints and likely outcomes. This is merely a first personal attempt to map some of those elements.

The most oracular words were expressed early on the project when OECD's Pascal Saint-Amans said that "[If G-20 members agree, the BEPS project could end up] redefining the architecture of international taxation, rules, tax treaties, guiding principles, recommendations, and decisions within the OECD …" (Daily Tax Report, February 13, 2013). The aim for a wide ranging international tax reform is masked under several key words of the project such as "pressure areas" "holistic approach", "international coherence", "integrity of tax systems", "fundamental changes" and "new international standards".

Let's recall quickly how the international tax architecture was initially designed. In 1921, the League of Nations, acting in response to an appeal for action aimed at eliminating double taxation, entrusted a team of four economists, Sir Josiah Stamp(UK), Professor Einaudi (Italy), Professor Bruins (Netherlands), Professor Seligman (US), with the task of preparing a study on the economic aspects of international double taxation.

The world then was not so dual faced with the clash between capital export countries and capital importing countries being nuanced if not almost non-existent. The drive at that time was to identify the "evils of double taxation" and to provide a coherent basis for allocation of taxing rights based on the doctrine of economic allegiance.

The remarkable side of this story is that globalization, in its full force, exacerbated the imperfections in the system formulated in the 1920s and also exposed capital export countries and capital importing countries to a new breed – the "capital inducer countries". If residence and source taxation principles were already under strain in a bipolarized world of the late 80's and 90's, the truth is that "capital inducer countries" took advantage of this architecture and bipolarization to aim at being more than "tax neutral" jurisdictions but inducers of investment, hubs for enterprises in global expansion. Such jurisdictions were framed as the correct juxtaposition between advantages from the investor perspective and the target of the investment perspective.

The whole national debates "I must have a competitive tax system" of the end of the last century and beginning of the 21st century was also largely driven to provide the domestic excuse for introducing mechanisms for inducing investment into the rather archaic tax systems and all countries reacted one way or the other to this trend through a myriad of tax preferences. When we look back to the Harmful Tax Competition projects of OECD/EU they were only partially successful because they focused on the more extreme forms of tax preferences and jurisdictions learned to innovate and adapt after that.

But the truth is that international tax architecture of tax treaties was simply not prepared for this dramatic expansion of international capital flows and the interaction of "international inducers" and "domestic inducers" lead to an inevitable lowering of the effective tax rate of entities operating internationally.

The game was played with the cards given to the players and the results may seem flawed to ones or amoral to others, but the real point is where not the governments and the OECD at the same table since the beginning?

So in my view the BEPS project is decisively not only a technically driven project to revamp the current international tax rules. There are several forces linked to this project such as the call for further transparency and corporate accountability on tax affairs that may lead to the tax "disclosure revolution" that the Economist recently referred. Other linked forces are the growing role of civil society organizations that have been rather effective new entrants to policy debates and also helped to shift the debate towards development issues. Another linked force is the politics side of the project with unilateral measures being pursued by countries (or even by the EU) in order to ascertain position in the debate and influence the final outcome.

The sponsor of the BEPS project is the group of twenty (19 nations among the top economies as measured in GDP and the 20th member being the European Union). At that level the BEPS is a grand master political chess game being played down in several platforms – with the OECD helping to contextualize the issues and drawing options.

Some of those countries announced unilateral measures such as the UK Diverted Profits Tax, Virtual PEs, retroactive GAARs, anti-hybrid rules and further interest deductibility rules may only be explained by the need to set the agenda, to lead the drive on core points of interest to those nations.

Faced with increasing public pressure, many governments then moved early and unilaterally with tax-raising measures and this trend goes well beyond the G20 countries. There are other countries that are playing the "wait and see approach" and others on apparent denial like the US, whilst their officials try to tame the tiger in the OECD boardroom. BRICS worryingly are taking a piecemeal approach choosing the bits that in line with their tax policy.

Finally, developing countries are also rightly wary of how BEPS may affect the value chain if embedded global tax harmonization movement affects directly or indirectly country-specific incentives to access to lower costs, subsidies for production, extraction and consumption.

The OECD predicted “global tax chaos” if the current consensus-based framework would not be altered and countries would move independently. Raising confusion and tax risks everywhere may also serve as the best justification towards the success of any difficult international consensus-based project.

The actual website of the G20 remarks that “success of the G20 is achieved with support from international organizations [such as the OECD], which provide advice on G20 priorities and help G20 members and guests identify policy gaps where actions will have the most impact”. The G20 found in the OECD the right pair to tango.

In reality, what we are facing is that the fastest way (and less intrusive) to implement BEPS is for the OECD not opposing those unilateral measures and later approach this trend from the need for coordination and coherence. The challenge for multinationals is not about if BEPS project becomes reality, it is how coordinated the process will be.

But global financial crisis is no longer current (although some ramifications remain present) and the tax debate has definitely shifted from lack of tax revenues (or the fair share of the piece of the tax cake) to accountability and hence the more recent focus on Country by Country reporting, which as readers know even predates the BEPS initiative.

There is a “momentum“ issue facing BEPS debate and actions and the window of opportunity is shorter as we advance. The compromise between BEPS and the economic drivers that indicate the need for further opening up markets and trade and creating jobs is also bound to play a role down the road.

So, if BEPS is the step to address some structural issues of the international tax architecture, that the same OECD through its consensus based approach helped design in the last decades (namely the maze of transfer pricing rules), then the next question is what should business do in this unpredictable marketplace?

Some people will say to you to stay one step ahead of the BEPS movements, but this is turning to be simply impractical if the movements are worldwide and new tax risks arise on a weekly basis.

In my view, BEPS is one way or another already reality and MNE should now focus also their attention on the need to reinforce practical dispute resolution mechanisms. If you go beyond the main countries, MAP is simply a global pandemonium. The OECD knows this and if BEPS outputs will be supported it will need to come together with the novel solutions to deal with the increased disputes and prolonged domestic litigations.

BEPS Implementation will require more “out of the box” thinking, pragmatism and political agreement to address implementation difficulties and the ideas floating around a “modular” multilateral convention coupled with mandatory arbitration deserves more attention.

Read for example the TRIBUTE initiative (short for “International Tribunal of Independent Tax

Experts”) for the establishment of a permanent international body specializing in the resolution of tax disputes, sitting on the Hague. This initiative is a sign that such step may not be far so ahead and mandatory arbitration or an international tax dispute settlement procedure should be tied with BEPS (see pages 378-385 of Action 14 public comments).

The reader may ask himself if this should be something we should push for now, after the “tax chaos” emerges or if we simply should wait for the emergence of the world tax organization in the post-BEPS world.

A fellow blogger made the case that “Lack of Political Leadership in Tax Matters reduces Global Welfare”. I agree with that statement but I believe this current lack of “leadership” is merely transitory and the BEPS project and the sister exchange of information movement are also instruments to assert that same leadership at international level. My prediction is that it will not be the voters or politicians but businesses that will claim that same leadership should emerge. Terrified of piecemeal approaches emerging from BEPS, businesses will probably support any global coordinated action that puts order to the international tax system. The solution looks more and more to be a world tax organization emerging from what is now the OECD Centre for Tax Policy and Administration.

Is this really what BEPS is all about?

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