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What do the Current OECD Proposals say about Global Tax Governance?

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The recent (February 2019) OECD document for public consultation introduced two proposals to address the challenges of taxation, the first one is the revised profit allocation and nexus rules in the digital economy (Section 2) and the second one is the global anti-base erosion proposal (Section 3). Even though the document is titled challenges of the digitalization of the economy, this document goes beyond, by introducing two rules in the global anti-base erosion proposal: an income inclusion rule and an undertaxed payments rule.

These two proposals follow up the introduction of the BEPS Project initiated by the OECD with the political mandate of the G20 and that has extended by means of the BEPS Inclusive Framework to non-OECD; non-G-20 countries including developing countries. At the time of writing (March 2019), 129 countries are participating in the BEPS Inclusive Framework and have committed to implemented 4 Minimum Standards which deal with harmful tax competition, tax treaty abuse, transfer pricing documentation and dispute resolution.

What is the role of the OECD in global tax governance?

Since developing countries were not part of the BEPS 44 group (G20, OECD and OECD accession countries), these countries did not participate in the setting of the agenda and the content of the BEPS Actions. However, by inviting non-OECD, non-G20 countries to participate in the BEPS Inclusive Framework, these countries were offered the equal footing on the implementation of the BEPS 4 Minimum Standards. Despite this equal footing, the legitimacy of the BEPS Project has been questioned by scholars and some developing countries since it does not address the needs of developing countries for allocation of taxing rights between source and residence.[i] At the same time the amount of technical resources (personnel, expertise) needed to implement BEPS Minimum Standards and to be regarded as compliant in the peer review process resulted in developing countries deviating resources from other important problems such as tackling informal economy, tax evasion by individuals among others.

In order to provide some answers to this question of legitimacy, the link between BEPS and the Sustainable Development Goals should be established so that even if developing countries did not participate in the decision making, the outcome of the BEPS Project will benefit these countries. However, at the time of writing, it has not yet been established that BEPS will help developing countries to achieve the 2030 Sustainable Development Agenda.[ii] Therefore, further research should be done by international organizations including the OECD and the Platform on

Collaboration on Tax in the link between BEPS and the 2030 Sustainable Development Agenda. This research is needed to legitimate the role of the OECD and G20 in respect of developing countries.

Involvement of actors/stakeholders

The BEPS Project is an important step in international taxation that also calls for a redefinition of the role of the OECD, and for more participation and inclusiveness of countries and actors participating in this process. These actors may vary for instance, business, business associations, judges, academia, government officials, members of the legislative. The success of BEPS requires involvement of stakeholders[iii] at all levels, and commitment of countries and actors to implement BEPS 4 Minimum Standards. Therefore, it is important that discussions on the implementation of BEPS take places at national level, and not only at OECD – government official level in the meetings of the BEPS Inclusive Framework taking place in Paris (France). Therefore, in our project Global Tax Governance in International Tax Law Making GLOBTAXGOV, one of the objectives is to carry out empirical research on the role of these actors in the implementation of the BEPS 4 Minimum Standards with a view to identifying the differences in the legal culture of the country that will result in a different implementation of the Minimum Standard than the one envisaged by the OECD and the BEPS Inclusive Framework peer review group. This research is being carried out in 12 countries with different legal and tax systems and from different regions i.e. the United States, Colombia, Mexico, Ireland, Spain, the Netherlands, India, Senegal, South Africa, Nigeria, Singapore and Australia. The GLOBTAXGOV Project has received funding from the European Research Council (ERC) under the European Union’s Seven Framework Programme (FP/2007-2013) (ERC Grant agreement n. 758671).

The income inclusion rule vis-à-vis developing countries

In addition to the response by scholars, business, think-tanks, tax advisors, to the public consultation document on the proposal on digital economy (Section 2), it is also important to address the global anti-base erosion proposal (Section 3) of the document and the introduction of an income inclusion rule. While acknowledging that developing countries often with smaller markets are dependent on natural resource taxation, and on tax incentives and free trade zones to attract foreign direct investment, the OECD states in the public document that global anti-base erosion proposal “seeks to advance a multilateral framework to achieve a balanced outcome which makes business location decisions less sensitive to tax considerations, limit compliance and administration costs and avoid double taxation”.

The introduction of this income inclusion rule calls for an analysis on the role of the OECD and the actors in global tax governance including the differences between developed and developing countries and the need of developing countries to introduce tax incentives to attract foreign direct investment

The proposal introduces the income inclusion rule that will supplement CFC’s rules and at the same time introduce a minimum tax based in the United States Global Intangible Low-Taxed Income (GILTI). Furthermore, since it mentions that Member States could choose to adopt the rule through an EU Directive, it may be reasonably expected that if the proposal is adopted, the European Commission will introduce a new Anti-Tax Avoidance Directive (ATAD 3) to introduce this rule.

The use of this minimum tax will result in developing countries who need investment to redesign their tax systems so that they can comply with this minimum tax and to continue being attractive for investors. For example, if the country has a tax holiday (0%), or a reduced tax rate (e.g. 5% for a specific business or if activities carried out in a free trade zone or special economic zone); and the minimum tax rate is 9%, the investor will be required to pay the difference between the tax rate (5%) given by the incentive in the developing country and the minimum tax rate (9%) in the country of residence, which most likely will be a developed country.

Would then, the minimum rate results in the revenue foregone by the developing country to be transferred to the developed country and that developing countries will be limited in their tax incentives including the tax rate since it cannot be below the minimum rate? In my view, this affects the sovereignty of countries to set up their own rules, but also the need of developing countries to attract foreign direct investment. Even if tax incentives are not the only motive to invest in one country, the tax incentives have helped to the economic development of under-developed/rural areas, and to the development and promotion of specific sectors that need investment (e.g. agribusiness, Eolic energy, river (fluvial) transportation, etc.).[iv] Therefore, foreign investors will need to ensure that their business is profitable from the beginning to be able to guarantee that there is enough profit to pay the minimum tax rate. Since there is not threshold for the application of the minimum tax rate, it could be reasonably expected that all business carried out abroad will be affected by this minimum tax rate.

What can be done?

In the author's view, the global anti-base erosion proposal and mainly the income inclusion rule will have a significant influence in the tax policy of developing countries to attract foreign direct investment.

The proposal of the income inclusion rule raises several questions in global tax governance, since by introducing this rule, developing countries have to reconsider their tax incentives, and the question is what developing countries will get in return? Would this proposal help to achieve the 2030 Sustainable Development Agenda? Would this proposal helps developing countries to attract foreign direct investment and if not, what can be done? One could perhaps look at the threshold, and the type of sector for which these minimum tax rate will be applicable, so that it does not affect sensible sectors in the country (agriculture/manufacturing) or does not affect underdeveloped areas that only with a tax incentive can the country guarantee that the foreign investor will be willing to participate in their development.

The current BEPS Project and its Inclusive Framework and the current proposal of February 2019 calls for a new and more inclusive role of the OECD, that also considers the needs of developing countries in this process, since all these changes are also affecting developing countries. Developing countries cannot be members of the OECD or the G20, therefore, this new role of the OECD should be exercised in close cooperation with the United Nations who is until now the only organization to which developed and developing countries can apply for membership.

[i] See I.J. Mosquera Valderrama, Legitimacy and the Making of International Tax Law: The Challenges of Multilateralism, 7 World Tax J. 3 (2015); A. Christians, BEPS and the New International Tax Order (2017)). Brigham Young University Law Review, at 1606; A. Christians & L. van Apeldoorn, The OECD Inclusive Framework, 72 Bull. Intl. Taxn. 4/5 (2018), Journals IBFD; I.J. Mosquera Valderrama, Output Legitimacy Deficits and the Inclusive Framework of the

OECD/G20 Base Erosion and Profit Shifting Initiative, 72 Bull. Intl. Taxn. 3 (2018);

[ii] The Link between International Taxation, The Base Erosion Profit Shifting Project and The 2030 Sustainable Development Agenda, no. W-2018/3. Bruges, Belgium: UNU Institute on Comparative Regional Integration Studies. Available at http://cris.unu.edu/sites/cris.unu.edu/files/W-2018-4.pdf

[iii] See also on the role of stakeholders from a political science perspective: Response to OECD Public Consultation Document -Addressing the Challenges of the Digitalisation of the Economy.

[iv] See for examples of tax incentives in the Latin American and Sub-Saharan African Region: Mosquera Valderrama I.J. (2015), The OECD-BEPS Measures to Deal with Aggressive Tax Planning in South America and Sub-Saharan Africa: The Challenges Ahead, Intertax 43(10): 615-627.

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