Combatting tax avoidance, the OECD way? The impact of the BEPS Project on developing and emerging countries' approach to international tax avoidance

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12 Summaries

12.1 English

Introduction

The Base Erosion and Profit Shifting (BEPS) Project, launched by the Organization for Economic Cooperation and Development (OECD) and the Group of 20 (G20) in 2013 marked a moment of intensification in global governance in the area of taxation of multinational enterprises. Previously international institutions had presented the outcomes of their deliberations as mere recommendations or models for domestic legislation or bilateral treaties. In contrast, the BEPS Project introduced a number of minimum standards subject to peer review and presented recommendations on a greater range of topics. Moreover, although initially only OECD and G20 members participated in the development phase of the BEPS Project, the geographical scope has been significantly increased after the creation of the BEPS Inclusive Framework in 2016. Whether to interpret these developments as positive has become subject to a significant amount of debate among academics, policymakers, and other observers.

Some see it as collaboration to end tax avoidance, others consider it as an imposition of powerful actors' preferences on less powerful ones, and a third group regards it as not impactful at all. Evaluating the accuracy of either interpretation subsequently depends on how countries act in practice: Whether policy standards should indeed be seen as devices by which powerful countries impose their preferences on less powerful ones depends on how they affect actors in practice. Likewise, it would be difficult to claim that there is cooperation when commitments to adopt certain policies are not followed in practice. Observing activity at the international level is therefore only the starting point of the analysis. The second step implies considering what the recipients of policy standards actually do with them. This dissertation focusses on the second step by asking:

To what extent has the BEPS Project impacted developing countries' approach to international tax avoidance?

To answer this question, I develop two typologies to that allow categorizing different international tax avoidance policies, which can then serve to evaluate the consistency between international standards and local implementation. Further, I conduct empirical case studies of the policy response by four countries with respect to two international tax problems.

The case studies were conducted in four emerging and developing countries: Colombia, India, Nigeria, and Senegal. They were selected

because it could be supposed that, among the wider subset of developing and emerging economies, they offer a wide range of potentially relevant features due to their differences in legal and political systems, size, level of development and structure of the economy. In particular, they represent different combinations of key variables that are a priori important for the degree of uptake of international standards: market power, exposure to the OECD processes, and capacity. In the four countries I conducted interviews with international tax policy stakeholders, to attempt to better conceptualize how the BEPS Project impacts policy decisions, on the one hand, and how international taxation is practiced by the tax administration, companies, and tax advisors on the other hand. The two policy areas I focus on are treaty shopping and transfer pricing. Both are among those that are considered as most relevant to capital importing countries.

Two heuristics to analyze the BEPS Project and international tax policies more generally

The first step I undertake in the analysis is introducing two types of typologies that are useful heuristics for analyzing what is proposed in the BEPS Project and international tax policies more generally. This is the focus of chapter 3. The first typology shows that international tax norms can be distinguished based on what type of country role in international tax planning they address. I distinguish three roles: a defensive, a facilitating, and a supportive role: policy standards developed by international organizations can target the jurisdictions that are on the (potentially) revenue-losing side of the problem (defensive dimension), they can target those jurisdictions the regimes of which are used to avoid taxes in other countries (facilitating dimension), or they can rather target headquarter countries (supportive dimension).

Second, examining in on the ways that countries on the defensive side can deal with the issue, one can further identify a multitude of options: A country can adopt a finely delineating response which consists in analyzing a taxpayer's behaviour as closely as possible to distinguish good from bad behaviour. Alternatively it can adopt responses that go more to the "root" of the problem by either eliminating benefits that taxpayers may attempt to obtain artificially (blunt response) or by eliminating taxes. For the sake of completeness, I also discussed the possibility and rationales of not adopting any response, and discussed ideas that attempt to address international tax avoidance through international harmonization. Each response comes with trade-offs with respect to administrability, tax revenues, effects on non-avoidant taxpayers or the required degree of international cooperation.

In chapter 4, I ask what the BEPS Project seeks to attain, and through which means. I find that, in terms of the heuristic developed in chapter 3, the BEPS Project mainly encourages finely delineating responses and discourages countries from addressing the problem in an overly indiscriminate manner. It should be noted that some features of the BEPS Project express more acceptance of what I termed as "blunt" solutions, compromising to

some extent with preferences that emerging economies and civil society organizations managed to bring into the process. However, the finely delineating philosophy is arguably still dominant. Finally, it is important to mention that nowhere does the BEPS Project require countries to actually defend themselves against tax avoidance.

In sum, whether the BEPS Project is therefore a driver, a limit, or not impactful... at all in countries' fight against tax avoidance is an open question. It should depend on what solutions they had in place beforehand or those they might have adopted in its absence. Knowing the latter is of course not possible with certainty. Nevertheless, case studies on the evolution of countries' policies in specific policy areas could improve our ability to assess where the BEPS Project had an impact and where it did not.

Domestic political economy of implementing international standards

In chapter 5, I discuss different features of countries that could explain why they adopt a certain approach to international tax avoidance at a certain moment in time. I first highlight the importance of carefully analyzing the status-quo ante of the legal and administrative system, arguing that how a country previously addressed international tax avoidance is likely to have an important impact on future approaches. Then I discuss the relevance of limits of structural features of developing countries, such as their position in the market for MNE investment, and a lack of administrative capacity, in explaining policy choices. Subsequently, I turn to the preferences and the influence of different governmental and non-governmental actors in the policy process. Here I use the typology developed in chapter 3 a heuristic to distinguish different policy preferences. I find that since the status-quo ante in terms of anti-tax avoidance policy was often judged as worse, businesses will support the introduction of anti-tax avoidance rules proposed by the OECD. However, the actual influence of businesses and other non-state stakeholders, in the process should not be overstated. Instead, the struggle over the approach to take is more often fought within government itself, opposing actors that favor ease of tax collection and those more concerned about the impact of tax rules on investment. It seems that the former prevails more often, and that the BEPS Project may have strengthened their position, even if the policy ultimately adopted is not necessarily the preferred response suggested by the BEPS Project.

Impact of the BEPS Project on transfer pricing policies and practice and approaches to treaty shopping

In chapters 6 and 7, I compare how the approach to international tax avoidance has evolved in Colombia, India, Nigeria, and Senegal as a response to the BEPS Project (or not) with respect to two important policy problems: transfer pricing and treaty shopping.

Broadly, the case studies show that the BEPS Project has left its mark on how countries approach the topic, although it is more worth highlighting where it has failed to do so and where countries have chosen to

diverge. First, when addressing transfer pricing, the countries studied have taken steps to bring their regulations more in line with the BEPS Project's approach, although important delays can be observed with respect to specific items. The approach to transfer pricing supported by the OECD prior to the BEPS Project has been emblematic of the finely delineating approach to international tax avoidance. Prior to the BEPS Project this approach was not accepted much by the countries studied, and it seems reasonable to extend this conclusion to most of the developing world. However, the OECD's approach has never been the only approach: Within the paradigm of the arm's-length principle itself, alternatives have been developed and used, such as certain aspects of the Indian transfer pricing regulations. In addition, other tax rules such as withholding taxes (and even value added tax) and foreign exchange rules condition to what extent transfer pricing actually is an issue for the erosion of tax bases. As the case studies suggest, these have not fully been able to deal with the problem, but they should not be omitted when assessing the overall trajectories of countries.

Whereas Nigeria and India diverge more in their policies than Senegal and Colombia, practice is most aligned in India, which can mainly be explained by the strength of India's court system, which imposes a greater discipline on the tax administration. The differences that can be observed across countries can be linked to the development of transfer pricing policy and enforcement prior to the BEPS Project, to differences in capacity, and to the accessibility of the dispute resolution system and market power. It is likely no coincidence that the higher market power of Nigeria and India corresponds to the greater divergences in the policies that are adopted. Capacity affects both the ability of countries to apply transfer pricing regulations in the spirit of the OECD in practice, their propensity to deviate from OECD rules (although not in a deterministic way as the Senegalese case shows) and the adoption of CbCR, where a lack of capacity means that the confidentiality measures necessary to receive information abroad are put in place in a delayed fashion. For the implementation of the OECD's transfer pricing approach in practice, the quality of judicial systems seems to matter most. There is more scope for auditors to apply transfer pricing in a blunt way and then negotiate with taxpayers when the latter face important hurdles for invoking the courts, such as in Senegal and Nigeria. Paradoxically, the pre-existence of an easily accessible judicial system also conditions the impact of BEPS Action 14, that is designed for enhancing international dispute resolution.

In terms of treaty shopping, countries have adopted different approaches, as well: Although the BEPS Project seems to have contributed to the fact that in those cases where treaty shopping caused important revenue losses – India and Senegal –, governments adopted some responses to stop treaty shopping after years of piecemeal enforcement or outright tolerance, they do not only rely on the BEPS Project's preferred solution but take decidedly stricter measures. The BEPS Project's recommendations to deal with it are largely in the spirit of the finely delineating approach although

they do not explicitly rule out that states adopt other responses. While the process to insert anti-abuse clauses seems to encounter an obstacle in the ratification procedures of the Multilateral Instrument (MLI) developed by the OECD (although not necessarily due to an opposition in substance), countries have resorted at times to other measures such as renegotiating or terminating treaties. The variation seems first of all due to a variation in the urgency of the issue: As in the case of transfer pricing, the extent to which treaty shopping has actually been a policy problem varies among countries. This depends on factors such as whether treaties have been signed with potential conduit jurisdictions and the degree of benefits these treaties confer compared to domestic law and other concluded treaties. Where the issue is more sizeable in terms of revenue loss, additional responses to the insertion of an anti-avoidance clause such as renegotiating or terminating are taken.

The fact that the BEPS Action 6 minimum standard only seems to be slowly making its way into countries' treaty networks concurs with the anecdotical evidence on other countries' renegotiations and terminations, even though the case studies also show that alternative responses are not adopted as alternative to BEPS Action 6 but rather as a complement. Another important observation though is that data beyond the four countries studied also shows that the phenomenon of treaty shopping is unequally distributed among countries, with some of them not being affected at all.

The case studies also suggest that which approach should be taken is usually a controversial question among different stakeholders within the country that is affected by treaty shopping, and even when the revenue loss is sizeable, it can take a long time until an action is taken. Considerations about investment attraction (i.e., the idea that even investors that are treaty shopping are bringing in welcome additional funds) and diplomacy are powerful counterweights. Other agencies (such as foreign affairs ministries, investment promotion agencies, or even the political level of the finance ministry) thereby act as domestic veto players towards a blunter approach, whereas the tax administration pushes for a more stringent response. Market power may play a role as the change in Indian policy over time illustrates. Fundamentally, even though the BEPS Project places an emphasis on a finely delineating approach, it may also have facilitated the adoption of blunter responses due to the propagation of the message that international tax avoidance is unwanted by the international community.

What to make of the findings? Contributions to the normative debate

In the final part (chapter 8), I review the normative debate on the BEPS Project and developing countries and explain where the analysis carried out in the preceding chapters can contribute to the debate (and where not). I propose that, when considering what countries do in practice, some of the critiques can be mitigated, as countries do not seem to unquestioningly adhere to what the BEPS Project suggests. Nevertheless, it is important to keep in mind that the countries researched might lack representativeness.

Finally, I remain critical of attempts to give the BEPS Project more coercive force, such as the inclusion of the BEPS minimum standards in the EU list of non-cooperative jurisdictions. This list, which is maintained by the Council's Code of Conduct Group, and the defensive measures that Member States apply against jurisdictions on the list are the EU's most important tools to promote its ideals of good tax governance abroad. The main criteria that affect whether a country will be considered as non-cooperative are the adoption of three types of policy standards: Exchange of tax information, fair taxation (similar to the OECD's definition of "harmful tax competition"), and the minimum standards of the BEPS Project. In accordance with the typology developed in chapter 3, I argue that the EU list should only include criteria that relate to the "facilitating dimension", i.e., discouraging other countries from adopting or keeping policies that facilitate international tax avoidance. However, only part of the BEPS minimum standards relate to that dimension. Others, such as BEPS Action 14, and parts of Action 6 and Action 13 should not be part of the listing exercise.