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Base Erosion and Profit Shifting

**Responses to questionnaire for developing countries from the UN
Subcommittee on Base Erosion and Profit Shifting¹**

The Subcommittee on Base Erosion and Profit Shifting Issues for Developing Countries was established at the ninth session of the UN Committee of Experts on International Cooperation in Tax Matters (the UN Tax Committee) in October 2013.

The mandate of the Subcommittee is to monitor developments on base erosion and profiting shifting issues, communicate with officials in developing countries and engage with relevant bodies such as the OECD on these issues.

The primary function of the Subcommittee is to communicate with officials in developing countries and ensure their views are fed into both the OECD/G20 BEPS project as well as the ongoing United Nations tax cooperation work.

A note providing information on the project established by the OECD and G20 to address global concerns with base erosion and profit shifting (the BEPS project) was released earlier this year. This paper was prepared to advance the work of the Subcommittee by providing information on these issues with the aim of obtaining the views of developing countries.

¹ This document has been slightly edited/updated to take into account two responses which were received after initial drafting.

To that end, the note included a short questionnaire on how developing countries view and prioritize the BEPS project issues – as well as any other base erosion concerns. The questionnaire was made available in English, Spanish and French.

Obtaining responses to these questions has been critical to ensuring the mandate of the Subcommittee can be fulfilled. The link to the relevant documents and questionnaire is at http://www.un.org/esa/ffd/wp-content/uploads/2014/10/BEPS_note.pdf

The questionnaire aims to be straight forward. Most responses have been posted on the UN website, but countries were free to request that their submissions not be made public if they preferred.

This report summarizes the responses to the questionnaire that we received to date. Some countries that have not answered the questionnaire have indicated that they may still do so. If we receive more responses, we will update this report to incorporate their views.

SUMMARY OF RESPONSES

The following countries made submissions which are available on the UN website:

Brazil	India	Singapore
Chile	Lesotho	Thailand
China	Malaysia	Tonga
Ghana	Mexico	Zambia

In addition we received two responses that were submitted by NGOs: a joint submission by Christian Aid and Action Aid and a joint submission by the Economic Justice Network and Oxfam South Africa. Several other countries that responded preferred to keep their responses confidential. However, we have still included the substance of their responses in this report.

All respondents said that BEPS had had a concerning impact on tax revenues. Over a third said that it distorted competition between domestic (generally small) and foreign (generally large) enterprises. Several countries referenced the additional tax burden that was put on other taxpayers if multinationals were avoiding tax and the impacts this could have on voluntary compliance.

Transfer pricing (TP) (including excessive management fees, IP and royalties and R&D) was the most commonly raised BEPS issue and better transfer pricing guidelines and legislation were seen as the primary tools to address it. Interest deductions associated with related-party debt, in particular debt levels, also featured prominently (although a few respondents mentioned the implementation of thin capitalization or interest stripping rules as counter-measures). To a lesser extent treaty shopping and preferential tax regimes were also cited as causes of BEPS.

A lack of information and capacity building were also common themes. Revenue authorities in developing nations struggle to establish, grow and upskill effective international tax teams. Some respondents cited poorly developed exchange of information (EOI) networks as being an impediment while others had networks in place but found that information was not received swiftly enough.

There appeared to be different views over how the level of tax paid by an MNE was judged to be appropriate or not, other than the standard tools of comparability and risk analysis.

All of the respondents agreed that the OECD BEPS Action Plan items identified in the questionnaire as developing nation priorities were important with disclosure of aggressive tax positions (Action 12) and transfer pricing documentation (Action 13) being the top concerns. This was closely followed by the transfer pricing actions on intangibles (Action 8) and other high risk transactions (Action 10), which includes management fees.

There was less agreement over whether there were other Actions that were not prioritized in the questionnaire but are nevertheless important to developing countries. However, the avoidance of PE status (Action 7) and the digital economy (Action 1) are the two Actions that were most commonly cited in response to this question.

The general themes emerging from the responses are comparable to those covered in the recently released International Monetary Fund policy paper, *Spillovers in International Corporate Taxation*.² The main difference is that transfer pricing concerns are emphasized more strongly in the UN responses and treaty shopping and natural resource exploitation features more prominently in the IMF paper.

Question one – how does base erosion and profit shifting affect your country?

All respondents stated that there is a BEPS issue with most citing the impact on tax revenue as a concern. However, two respondents noted that there is no formal quantitative measure of the lost tax revenue. One country estimated that between 2007 and 2012, transfer pricing operations in that country amounted to US\$370 billion.

About half of the respondents stated that BEPS distorts competition and is unfair, because it increases the tax burden on other taxpayers – with many using the divide between SMEs and large businesses as an example.

Four countries were concerned with the potential negative impact BEPS has on the credibility and integrity of the tax system (and voluntary compliance).

Three countries stated that profits should be taxed where the economic activity takes place. Two additional respondents noted that there is a level of disconnect between the economic activity and where the income is reported for tax revenue/where tax is paid. One country noted that the source country has to bear the cost of doing business (for example, infrastructure, waste management, and social development), which doesn't match the amount of tax paid.

² <http://www.imf.org/external/np/pp/eng/2014/050914.pdf>

Three responses mentioned the use of artificially contrived arrangements.

One country linked BEPS problems to developed countries' preferences for residence taxation over source taxation and the influence those countries have had on the formation of the international tax rules.

One country noted that due to its geographical location, most firms in that country are foreign-owned. This combined with its relatively high tax rates means that companies are engaging in serious tax planning.

Question two – if you are affected by base erosion and profit shifting, what are the most common practices or structures used in your country or region, and the responses to them?

Half of the respondents identified that transfer pricing (or transfer mispricing) specifically is a major problem. Many of the other respondents raised concerns about excessive or unwarranted intra-group payments without specifically mentioning transfer pricing (for example, only normal/routine compensation being provided for important R&D performed).

Over half of the respondents mentioned transfer pricing legislation/action as a response to BEPS. Two have recently enacted transfer pricing legislation, although one country has said that they do not yet have the capacity to apply the rules. Others have strengthened existing transfer pricing legislation, or have introduced controls and documentation requirements. One country has conducted a transfer pricing consultation programme that reminds taxpayers to keep good documentation. This particular country has also been concluding bilateral advance pricing arrangements that leverage off the OECD's guidelines on arm's length pricing. One country cited linked having an "aggressive approach" to transfer pricing to higher profits being declared in that country.

The level of debt (particularly related-party debt) and the pricing of such debt was a common theme, with about half of the respondents raising one or the other as a major concern. However, only three respondents mentioned the implementation of thin capitalization rules as a means of addressing these concerns.

Six responses raised the pricing of IP/royalty payments as a concern.

Deductible payments for management/consultancy fees along with technical services fees were raised as concerns by over half of the respondents.

Two countries have responded by having withholding taxes on payments related to technical services and one on royalty payments.

One respondent cited that, in general, the charging of withholding taxes on payments is a useful aid in countering base erosion and profit shifting practices.

Four countries specifically stated that treaty abuse/treaty shopping was a problem. A further six mentioned the shifting of profits to low- and no-tax jurisdictions and jurisdictions with harmful preferential tax regimes.

One country has responded by having higher withholding rates on payments to low-tax jurisdictions.

One country has been reconsidering its treaty provisions and another country has been renegotiating old double tax agreements (DTAs) that are being used for BEPS.

Two countries noted that the response to BEPS via DTAs has been limited because of a lack of DTAs and tax information exchange agreements (TIEAs). One country has only one DTA, while another has no DTAs, but has two TIEAs in the pipeline.

Two countries raised the digital economy as a concern. Another was concerned about the offshore sale of tourism packages over the Internet for tourism services being provided in the country. A third respondent was concerned about the sale of goods and services over the Internet to residents more generally. One country said that they had amended VAT legislation to require offshore providers of electronic services to register for VAT.

Two countries noted that their policy to provide tax incentives to new investment in selected sectors was causing BEPS problems. As a response, one country has scaled down tax holidays and rationalized tax treaty incentives.

One country stated that the artificial transfer of tax residence was a concern.

Two respondents (one country and one civil society) identified high net-worth individuals as creating BEPS issues.

Three respondents have responded by focusing on human resources. One has created a transfer pricing unit and has been building capacity in terms of staff in international taxation. The other two have focused on technical training.

Four respondents have also relied on general anti-avoidance rules (GAARs) or other domestic anti-abuse legislation.

One country cited continued emphasis for source-based taxation as a BEPS response.

One country's most common response is the audit process, but a major limitation is the limited skills of the auditors.

Note that some countries did not address the response part of the question.

Question three – when you consider an MNE’s activity in your country, how do you judge whether the MNE has reported an appropriate amount of profit in your jurisdiction?

One respondent stated that they are currently able to do this precisely. Another stated that is difficult to judge until a thorough audit has been completed.

Three respondents stated that activities undertaken by an MNE are dealt with in the same manner as resident taxpayers. A fourth respondent said that they have no special mechanisms.

Over half of the respondents state that they look at comparable businesses in that industry/sector.

Most of the respondents use risk analysis tools to identify those who haven’t complied with their obligations. From there, audit cases are chosen. Some respondents talked about risk assessment and audits in a more general sense, but a few talked about these in the context of transfer pricing. One country is about to move to a risk analysis methodology from their current state on relying on detailed audits to identify issues.

One country stated that they look specifically at cross-border transactions during the audit process.

One country said that taxation should be aligned with substance so the allocation of profits should follow substantive economic activities that are undertaken and the best way to achieve this is to have robust transfer pricing guidelines surrounding the arm’s length principle. It also uses a strict matching principle for deductions – deductions have to be closely matched to the income that is being produced.

Question four – what main obstacles have you encountered in assessing whether the appropriate amount of profit is reported in your jurisdiction and in ensuring that tax is paid on such profit?

A lack of information was raised as the major obstacle by most respondents, although for different reasons. Over half stated that there is a lack of effective exchange of tax information, or when there are exchange-of-information mechanisms in place, information is not provided in a timely manner.

Several respondents stated that companies are often uncooperative. A few others stated that there is a lack of transparency when it comes to international value chains.

Over half of the respondents stated that a lack of data on comparable businesses/industries/sectors is a major problem.

Seven respondents raised concerns about resourcing – due both to a lack of technical skills and insufficient resources.

Three respondents stated that a major obstacle was inadequate legislation/legal infrastructure. An additional respondent stated that there are no robust standard transfer pricing guidelines in place.

One country stated that a major obstacle is the lack of specific rules relating to the digital economy.

One country stated that a major obstacle is the presence of a significant unregulated cash economy.

Another country considered that there was a lack of specific rules relating to branches which caused them problems.

One country stated that a major obstacle is the fact that multinational enterprises are doing their reporting on the basis of tax laws in the country of the head office, rather than the laws of the country in which the branch or subsidiary is based. This country also stated that a major obstacle faced by auditors is the fact that an enterprise's records are kept in the country of the head office, so available information is limited.

Question five – do you agree that these are particularly important priorities for developing countries?

All but one respondent agreed that these were priority actions for developing countries.

One country said that it was not possible to generalize the priorities of such a diverse group of countries.

Question six – Which of these OECD's Action Points do you see as being most important for your country, and do you see that priority changing over time?

18 countries responded to this question. Most countries did not see priorities changing over time.

Eleven countries included Action 10 (TP – other high risk), Action 12 (Aggressive tax planning disclosure), and Action 13 (TP – documentation) in their response to this question.

Ten countries included Action 4 (Interest deductions) and Action 8 (TP – intangibles).

Nine countries included and Action 9 (TP – risks and capital).

Eight countries included Action 11 (data analysis).

Seven countries included Action 6 (Treaty abuse).

One country said that all of them were priorities. One country said that its priorities might change as new cases emerge.

Question seven – Are there other Action Points currently in the Action Plan but not listed above that you would include as being most important for developing countries?

Eight countries included Action 7 (Avoidance of PE status)

Seven countries included Action 1 (Digital economy)

Four countries included Action 5 (Harmful tax practices)

Three countries included Action 3 (Controlled foreign company rules)

Two countries included Action 2 (Hybrid mismatch arrangements)

One country included Action 14 (Disputes resolution) and one country included Action 15 (Multilateral instrument).

Question eight – Having considered the issues outlined in the Action Plan and the proposed approaches to addressing them (including domestic legislation, bilateral treaties and a possible multilateral treaty) do you believe there are other approaches to addressing those practices that might be more effective at the policy or practical levels instead of, or alongside such actions, for your country?

Capacity building (including training, improving risk analysis tools, technical assistance and access to databases) was raised by eight countries.

Two countries suggested that the OECD should produce guidelines on the BEPS items.

Other suggestions included expanding the tax sections of the OECD guidelines for multinationals, getting multinationals to include commitments not to pursue BEPS strategies in their corporate governance documents, and allowing some flexibility so that countries can adopt rules that fit their situation/environment.

One country said that any BEPS changes should not impede economic growth or limit the use of growth enhancing tools like tax incentives.

One country suggested that robust anti avoidance legislation, both general and specific rules, were essential.

Question nine – Having considered the issues outlined in the Action Plan, are there any other base erosion and profit shifting issues in the broad sense that you consider may deserve consideration by international organisations such as the UN and OECD?

Two countries wanted to see a summary of submissions on this questionnaire.

Two respondents suggested a rebalancing of source vs residence taxation in tax treaties.

Other suggestions included guidelines for domestic GAARs, guidelines of how to run, resource and fund international tax teams (e.g. TP units), expand the EOI network, look into branches and the cash economy, advice on business restructuring, analysis of the harm done by tax incentives, set up a global forum for BEPS.

One country suggested that trade mispricing (a broader issue than simply transfer pricing) which includes issues relating to fraud and illegal activity was important.

One country suggested that e-commerce should be considered.

Another country would like capital gains taxation to be considered to ensure that there is more source taxation.

Question ten – Do you want to be kept informed by email on the Subcommittee’s work on base erosion and profit shifting issues for developing countries and related work of the UN Committee of Experts on International Cooperation in Tax Matters?

All countries wished to be kept informed.
