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Ref: OECD DISCUSSION DRAFT: BEPS ACTION 11 (IMPROVING THE ANALYSIS OF BEPS)

Dear David

BIAC thanks the OECD for the opportunity to provide comments on its Discussion Draft on Action 11 (Improving the Analysis of BEPS) of the Base Erosion and Profit Shifting Action Plan issued 16 April 2015 (the "Discussion Draft").

In the attached document, you will find a number of both general and specific comments, setting out our feedback and concerns in response to the Discussion Draft. First, we acknowledge and welcome the fact that you have taken considerable care to try to distinguish the effects of real economic activity from the effects of BEPS-related activity. We welcome the balanced way in which you have interpreted the data, which gives us confidence that your subsequent analysis of the effects of implemented BEPS recommendations will be useful. Second, as you will see, we do have questions about the possible indicators listed in the Discussion Draft. In our view, some do not seem appropriate conceptually. In other cases, however, modifications might be possible, and we would be happy to discuss those latter ones further at the public consultation and beyond.

We very much hope that you find our comments useful, and we look forward to working with you on these important issues over the next few months.

Sincerely,



Will Morris
Chair, BIAC Tax Committee

1. BIAC welcomes the opportunity to give comments on this very important subject. Policy responses should always be proportionate to the issues at hand. It is therefore important to gather facts and to analyse the consequences. The Discussion Draft is comprehensive and well balanced. The difficulties of assessing BEPS should not be underestimated. It is truly difficult to distinguish real economic effects from tax effects and BEPS-related behaviour.
2. BIAC agrees with the Discussion Draft regarding the difficulties to assess where profits arise in the complex value chains increasingly applied throughout the business community. Since the corporate profit tax is, and should be, levied on profits rather than on single production factors or sales, there is a need to assess how total profits are obtained in the value chain. Corporate behaviour is influenced not only by national tax policies but also by economic activity, the business cycle and the behaviour of investors, financiers, competitors and consumers. To assess BEPS entails separating out all these other effects. It is truly a complex task.
3. BIAC believes that paragraphs 13, 68, 101 and 102 in particular provide much needed clarity on the definition of BEPS and therefore gives guidance on which situations should and should not be targeted. The focus of BEPS should be on artificial arrangements to exploit the differences in countries tax rates and/or tax policy instruments. This also means that the use of such instruments in and of itself can and should not be classified as BEPS, nor should BEPS countermeasures be applicable to these situations. Paragraph 102 states *“If economic functions, assets and risks are effectively relocated to another country to take advantage of a low rate or tax credit, this does not constitute BEPS.”* As paragraph 104 further states: *“By definition, BEPS behaviours involve artificial shifting of profits without changes in the location where the activities creating those profits take place”*. No or low taxation is not per se a concern, but unintended double non-taxation or less than single taxation as a result of artificial profit shifting is. Thus, profits (and losses) ought to move if the functions, assets and risk are in fact relocated. We would urge the OECD to use these paragraphs as the key-stone to reassess whether each Action Point individually and all Action Points collectively are adequately targeted and do not have unintended spill-over effects regarding genuine economic activities.
4. In this respect, paragraphs 107, 108 and 176 state that corporate income taxation is a form of taxation that is the least conducive to growth, an increase of the corporate income tax burden for MNEs as a result of BEPS countermeasures should not be allowed to have adverse economic effects. In other words, BEPS countermeasures must be carefully targeted and not cause an increase of the effective tax burden regarding real economic activities. If the latter should be the case, and business is wary of the fact that the Action Points could very well go beyond artificial arrangements and also impact real economic activities, it should be recognized that the BEPS countermeasures would result in adverse economic effects. The administrative costs must also not be allowed to hamper growth and job opportunities.
5. From paragraph 181, it follows that BEPS should be handled in a revenue neutral manner, thus underlining the necessity to strike a very careful balance in designing the BEPS countermeasures to prevent throwing away the baby with the bathwater.

6. BIAC agrees that one of the key challenges with available data sources is that it is difficult to disentangle real economic effects from the effects of BEPS-related behaviours. Estimating the effects of BEPS requires a need to establish a counterfactual; i.e. what would the outcome have been without BEPS. There is a need to exclude the effects of real economic activities across countries independent of taxes as well as the effects of real economic activity across countries by differences in non-BEPS-affected tax rates (a change in the effective tax rate in the country/countries, introduction of investment incentives etc.). This also means that there is a need to distinguish normal tax planning from aggressive tax planning and tax avoidance.
7. The difficulty of disentangling normal tax planning and BEPS activities is not addressed in most of the empirical research that is referred to in paragraphs 150, 151 and 152. There is no conclusive proof of artificial shifting of profits and/or the extent to which this occurs.
8. The Discussion Draft provides a high-level overview of the available economic analyses of the scale and impact of BEPS. Two approaches to estimate the scale of BEPS are proposed, the aggregate tax rate differential approach and the BEPS channels approach. The latter approach would assess BEPS from each channel (action point) while the former would try to estimate a hypothetical situation without any BEPS.
9. The BEPS channel approach appears to insufficiently recognize the fact that this approach would be based on so many variables that it would be very difficult to reach a well-founded conclusion. This is exacerbated by the fact that there at this time is no reliable data available on firm level.
10. BIAC agrees with the assessment in the Discussion Draft that neither method has a definite clear advantage. However, it does not mean that multiple approaches necessarily should be used. It is important to keep in mind the data requirements and the costs for businesses of having to submit more and more information. In this regard, we note that Paragraphs 27-29 identify the need for governments to have access to more extensive firm-level data. Although firm-level data may indeed provide more in-depth insights in some ways, it will be important to balance the additional cost to business of providing such data with the expected benefit. In addition, to the degree that more extensive information is demanded and used for analytical purposes, BIAC believes it is very important to ensure that robust and reliable mechanisms exist to ensure taxpayer confidentiality is respected.
11. Both approaches would call for a need to separate real economic factors and tax policy measures from BEPS. This task seems almost impossible. Difficulties may be reduced somewhat given that BEPS is likely to be limited to a small fraction of MNEs and may be concentrated to only some countries. Nevertheless, it is important to isolate the effect of real economic activity variables and the effect of changes in the effective tax rates in countries from BEPS-related activities. As stated in the Discussion Draft, extrapolation from a few observations and a non-random sample should be avoided.
12. BIAC strongly supports the view expressed in the Discussion Draft (par 68) that “**Indicators should distinguish between BEPS and real economic effects of current-law corporate income tax features.** Indicators should focus on tax shifting due to BEPS, not real economic responses to tax rate differences that reflect the impact of current-law provisions adopted by legislators,

including incentives to expand business operations in their country. Legislated or discretionary tax incentives can have an important impact on reported corporate income tax payments that reflect the location of real economic activity. The challenge in developing indicators is distinguishing between the economic effects and BEPS.”

13. BIAC also agrees with the view in the Discussion Draft (par 74) that *“The data used to measure most of the indicators discussed in this paper unavoidably mix the influence of real economic activities, corporate income tax policies adopted to encourage business development, and BEPS.”*
14. Regarding the questions on page 19:
 - Are there any additional criteria that should be used in assessing data for analysis of BEPS?
 - Are there other data sources not described in this chapter that would add significantly to the analysis of BEPS? If yes, what are these data sources? Are these data currently collected, is their coverage comprehensive and, if data covers more than one country, is the data representative across the countries? Are they available for analysis, and if so, who can access them?
 - Do you believe existing data is sufficient to perform reliable analyses of BEPS and countermeasures? If yes, why? If no, what data is needed to undertake a comprehensive analysis of BEPS and countermeasures?
 - Are there other “best practices” that governments could feasibly institute to improve coverage and/or access to existing data?
15. BIAC is not aware of other data sources readily available to distinguish BEPS-related activities from other sources impacting business decisions. BIAC however, believes that purely national tax policies affecting real economic activity through changes in non-BEPS-affected tax rates may very well influence BEPS-related activities. If a government imposes punitive tariffs or taxes, businesses may try to circumvent such rules by BEPS-related measures. Confiscation of previously allowed allocations may drastically change corporate behaviour and some business measures may be heavily tax induced. Even though they are not artificial in nature they may be viewed by tax authorities nevertheless as artificial and part of aggressive tax planning. The Discussion Draft does not appear to attempt to assess the impact of any such changes in national tax policies.
16. BIAC is of the view that indicators developed in the Discussion Draft suffer from so many deficiencies that presented information is not sufficient to analyse BEPS. Many of the indicators suffer from being difficult to assess since the countries included vary from one indicator to another and over time. It could be desirable to try to have the same countries included in various analyses.
17. The list of questions on page 48 is very much in the direction of fine tuning indicators which the Discussion Draft already express have severe difficulties in isolating BEPS-related activities from other factors.

18. The questions are:

- For indicators that use a specific group of countries (e.g., top 15 countries) or different groups of firms (e.g., global top 250 companies), how should changes over time in the composition of the groups be handled? While maintaining the same composition over time ensures year-by-year comparability, annual changes in the composition would result in a more representative measure of the current value of an indicator.
- How could information about the distribution of observations used in calculating an indicator be provided as part of any analysis?
- How should the results be reported? Depending upon data availability, the indicator values may be reported globally, by country, by industry or other categories.
- Should any of the included indicators be dropped? What additional potential indicators could be included?
- The indicators based on consolidated and unconsolidated tax and financial data have been calculated using the data as reported. This includes, in some cases, using negative values for reported net income and tax expense. It also means that “outliers” are being used in the calculations.
 - Is this a reasonable approach in dealing with the limitations of reported data?
 - Are there suggestions on systematic ways to deal with extreme outliers?
 - Should affiliates reporting financial statement losses be included or excluded? If included, how should negative values be handled?
- Will the suggested set of indicators when considered together provide sufficient information for a strong indication of BEPS? If not, what indicators should be added or modified?

19. BIAC would like to give the following comments on respective Indicator. We broadly agree with the caveats presented under each indicator. We value the openness and frank presentation of the indicators.

20. It should be clear that none of the indicators in and of themselves give conclusive evidence, but they can be useful to provide for a rudimentary risk assessment that could result in closer examination or to provide an opportunity to MNEs to give a satisfactory explanation that there is no BEPS concern.

21. The development of indicators should not lead to additional reporting requirements for MNEs, and the design of the indicators should be reliant as much as possible on currently available information and/or additional information that will be available to tax authorities through other Action Points. The question on page 48 (paragraph 96) should therefore be answered in the negative.

22. The information need not (all) be available publicly, it is sufficient that tax authorities can conduct the risk assessment. Confidentiality of proprietary information should be safeguarded.
23. In addition, insofar the indicators should lead to closer examination and/or additional information requests, the tax authorities should address these to the global headquarters rather than engaging the MNE at a local level.

Indicator 1: The concentration of foreign direct investment to GDP.

24. BIAC questions whether it is appropriate to mix stock and flow variables. When markets open up, the GDP of the region or country may be low and large FDI inflows should not be taken as a BEPS-indication. It is also wrong to implicitly make a value judgment on the tax policy undertaken by a sovereign state imposing a below average corporate tax rate.
25. This approach could put all FDI in a single country in a negative light, regardless if the FDI represents genuine economic activities. The indicator is likely to capture only a small portion of all FDIs and some smaller countries may question whether this is appropriate. BIAC sees few merits for this indicator as presented.

Indicator 2: High profit rates of low-taxed affiliates of top global MNEs

26. Profitability may vary from market to market irrespective of the ETR. Assets should not be the only measure of economic activity used, in particular if they have not been adjusted for functions and risks. Furthermore, the tax variable does not reflect actual taxes or tax liability on current-year income. Moreover, real economic activity variables and tax rules may influence the results rather than BEPS-related activities.
27. The assets summed up in paragraph 90 are more or less limited to the brick-and-mortar economy and might therefore not give a fair measure of economic activity. Even though there is no separate digital economy, it is clear that these types of activities are pervasive in all sectors of the economy. Also other intangible assets or activities would not be taken into account. By doing so, there could be a question how sustainable such an indicator would be in the longer run. It should therefore be clear that certain functions and risks (as described in the Transfer Pricing Guidelines for MNEs and Tax Administrations) also constitute genuine economic activities and should therefore not be discarded in the corresponding indicators.
28. For indicator 2, there is a need to distinguish between the profit rate and profit level, and the level of taxation from ETR. With this measure, it will not be possible to distinguish the legitimate utilisation of tax incentives from real BEPS activities. Firm characteristics and the countries which are included must be controlled for.

Indicator 3: High profit rates of MNE affiliates in lower-tax locations

29. The analysis has not controlled for the fact that mature economies may have higher corporate tax rates and higher capital intensity. Since risks are typically greater in developing countries, profits also need to be greater on average. The fact that production in less developed countries tends to be more labour intensive may increase profits relative to assets. The same caveats as for indicator 2 applies.

30. There should also be room to compensate for the extent that certain economic activities are high value adding and others are low value adding. It would make sense if the indicator could flag low levels of profit connected to high value adding activities and the other way around. Otherwise, there is a danger that this indicator would only flag normal tax handling instead of BEPS concerns.

Indicator 4: Profit rates compared to effective tax rates for MNE domestic and foreign operations

31. The plot in figure 2.3 shows a very dispersed outcome. Many businesses experience different profitability due to the need for market penetration or other economic circumstances. BIAC agrees with the caveats presented in the Discussion Draft. The variation in the numbers presented in Table 2.3 and in Figure 2.3 would call for serious concerns using this indicator. As for the other indicators presented, the lack of credible explanation of underlying changes from year to year or from country aggregate to other country aggregates is striking. Which BEPS-related activities would explain such variation in the results?

Indicator 5: Effective tax rates of MNEs compared to comparable domestic firms

32. It will be hard to find domestic comparable companies, especially in small open economies. The nature of activities undertaken by MNEs and the income they earn tends to differ to domestic firms. Because of globalization and falling transactions costs, an increasing number of firms are established in more than one country. This is also often the case for firms servicing only the domestic market since they are frequently subsidiaries to MNEs in other countries. There are often specific circumstances for companies to refrain from engaging in competition in foreign markets. Such characteristics distinguish these businesses from other businesses and it obviously also impairs the possibilities to make appropriate comparisons with MNEs. The tax treatment of outbound versus inbound investment, interaction with tax treaties and interactions with domestic tax systems (dividend imputation rules, incentive schemes etc.) may lead to differences in effective tax rates and must be controlled for as well as for genuine commercial activities. It seems that comparisons would lead to very skewed results.

Indicator 6: Royalties received compared to R&D spending

33. Research and development include current plus capital expenditures on both public and private R&D activities performed within a country. Royalty receipts are payments for the use of intellectual property that may not be directly related to the measure of R&D spending. The countries included vary and the time lag between royalties received and R&D spending is not dealt with in a satisfactory way.
34. This metric appears not to capture the possibility that IP is transferred across borders for non-BEPS business reasons. Sales of IP at fair market value would not give rise to BEPS, but would inflate the proposed metric.
35. The indicator seems to be sensitive to changes in R&D expenditures, which vary between countries and over time for economic reasons. If R&D expenditures fall rapidly during an economic crisis affecting a limited number of countries more than others, the indicator might

increase regardless of any BEPS-activities, at least as long as royalty payments are less volatile. BIAC has serious doubts about the validity of this indicator.

Indicator 7: Interest expense to income ratios of MNE affiliates in countries with above average statutory tax rates

36. The measure included is not net-interest payments. This is a major and unacceptable deficiency. Furthermore, the effect of the corporate tax rate level on leverage seems not to be controlled for.
37. It stands to reason that the indicator regarding interest deduction has to be in alignment with the outcomes of Action Point 2 and 4. It makes no sense if the interest-to-income ratio under the Earning Stripping Rule could be 1.3:1 (net interest payment!) but that the same or smaller ratio would put up a red flag under this indicator.
38. Questions on page 74.
 - Are there any alternatives to the two approaches (aggregate tax rate differential and BEPS channels) for measuring the scale of BEPS?
 - Are there recommended approaches for extrapolating from studies based on a non-random sample of MNEs, from individual countries or limited countries, to a global estimate?
 - Are there other important empirical studies about the scale or economic impact of BEPS and/or the Action Items which are not included in the reference listing?
 - Are there additional empirical studies about the effects of BEPS in developing economies? What would an ideal economic analysis of the scale of BEPS include – data, dependent variable, tax variable, independent variables?
 - Are there other analyses of BEPS that governments' tax administrations or tax policy office might consider with currently available data?
 - Would internationally-coordinated BEPS countermeasures increase or reduce taxpayer compliance costs relative to your expectation of future country tax rules in a world without the BEPS project, and what would be the key determining factors?
 - Are there studies of the cost of compliance with international tax rules, and do any of them estimate the cost of complying with non-internationally coordinated tax rules?
 - Are there any studies that estimate the costs of MNE international tax planning?
 - Are there additional empirical studies on the competition issue between companies and on the competition (spill-overs) issue between countries?
 - Are there empirical studies that analyse whether reductions in ETRs from BEPS behaviours have different economic effects (e.g., efficiency, incidence, welfare) from general reductions in ETRs from legislated policy changes?

39. BIAC strongly advises against extrapolating. It is important to present credible assessment of BEPs and measures conducive to assessing the effects of policy actions taken. The risk of increased international double taxation must be handled in a decisive and appropriate manner. All increases in administrative costs will lead to decreases in investment and employment levels so it is necessary to minimize such increases for this Action point, as well. Since several of the measures may result in policy changes in excess of what is called for to address BEPS, any developed methodology to measure BEPS should also be able to assess the likely real reallocation of resources, investment and job opportunities between countries that follow due to enacted legislative changes due to the Action points in BEPS. If a business is assessed higher income in a country due to tax rule changes, there will be an incentive to relocate production and costs to that country as well. Such a development may have serious tax revenue consequences for individual countries.
40. When reading paragraph 179, it is interesting to note that the OECD appears to give some argumentation against there being an apparent race to the bottom. In fact, CIT revenues have been rather stable relative to GDP.
41. There is a need to develop best practice in the government sector and to evaluate indicators and measures presented over time of BEPS. BIAC stands ready to give input in this process of improving the analysis of BEPS.