G-20 Plans to Overhaul International Corporate Tax System Still on Track

Proposals Would Make it Harder for Companies to Shift Profits to Low-tax Countries

By
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Pascal Saint-Amans is the OECD official leading the overhaul of the international tax system. OECD Image Library

Plans to overhaul the international tax system to make it more difficult for companies to shift profits to low-tax countries remain on track, with the Organization for Economic Cooperation and Development meeting an ambitious deadline on Tuesday for presenting a first set of new guidelines to finance ministers of the Group of 20 largest economies.

Launched by the G-20 last year, the overhaul is intended to modernize a web of 3,000 bilateral tax treaties and national tax rules that dates back to the 1920s and allows companies to adopt legal structures designed to shift their profits to the lowest-tax jurisdictions, regardless of where those profits are generated.

The proposals were agreed by the Committee on Fiscal Affairs, which includes representatives from the 34 countries that are members of the OECD, two candidate nations, and eight large developing economies, including China, India, Brazil, Russia, Indonesia and South Africa. The CFA is due to produce a second, and final set of proposals next year.

Pascal Saint-Amans, the OECD official leading the overhaul, said the fact that those 44 countries had delivered on time and across a range of complex tax issues underlined
how committed they were to closing loopholes that have allowed companies to minimize their tax payments.

"This is extremely ambitious," Mr. Saint-Amans said in a news conference. "We are delivering. As soon as they are published, they will have an impact. They reflect very strong agreement."

But tax experts warned that agreement between governments on the outlines of new tax rules is a first step that must be followed by changes in domestic legislation in each of the participating countries that could take many years to complete and implement.

"History has shown that countries act in their own interest, and accept those recommendations they like," said John Wonfor, global head of tax at the business advisory firm BDO International. "We might not get the coherence the OECD would like."

Nevertheless, the OECD said the prospect of new rules that will end many existing ways of shifting profits to low-tax jurisdictions will have an immediate impact on the behavior of international companies.

"If you're a tax planner, it is difficult to sell your scheme to a company that knows this will be over in a few years," said Mr. Saint-Amans, director of the OECD's Centre for Tax Policy and Administration. "This will give them time to undo those schemes. We're having an impact already even though it hasn't come into force."

Tax experts said the new guidelines could have an impact on the way companies operate internationally, even if they aren't adopted in their home countries.

"The OECD's initial guidance..., if adopted by key OECD member countries and observers as expected, will have a significant impact on U.S. multinationals with overseas operations, whether or not the U.S. makes changes in regulations or practices as a result of the recommendations," said Manal Corwin, national leader of International Tax at KPMG LLP and a former deputy assistant secretary for tax policy for international tax affairs at the U.S. Treasury Department.

One of the new guidelines aims to update rules on how services and goods transferred between units of a company in different countries are priced to reflect the fact that many are now "intangible," in the form of licenses and the use of branding. That makes it more difficult to establish a fair value for the cost of those services, and allows companies to record the bulk of their profits in low-tax jurisdictions where ownership of licenses and brands are located, but where no other economic activity takes place.

The 44 countries have also agreed on a new template for country-by-country reporting by companies, which will require them to report the amount of revenue, profit and tax paid in each jurisdiction, as well as their total employment, capital and assets used in each location.

They also proposed new rules that would eliminate opportunities for avoiding tax through the use of complex financing structures that are known as "hybrid mismatch arrangements", as well as what are known as harmful tax practices, or national rules that grant preferential treatment to certain activities. However, they failed to agree on the treatment of "patent boxes," which are used by some countries to encourage innovation by allowing a lower rate of tax to be charged on profits from new inventions.
And in a step that could make it easier to implement some of the proposed changes, the 44 governments said it should be possible to design a new, multilateral agreement that would overhaul and replace existing bilateral tax treaties.

The planned overhaul of tax rules comes as governments around the world are seeking to raise more tax to cut their budget deficits and bring down high levels of debt accumulated in the years since the onset of the financial crisis. It followed controversies in a number of countries—including the U.S., the U.K., France and Germany—over the behavior of a number of companies that operate in the digital economy.

In Europe in particular, anger has mounted in recent years over the complex tax structures that allow large, often American firms to pay little or no tax at a time of brutal cuts to national budgets.

The European Commission, the European Union's executive arm, opened formal investigations in June into the tax practices of three multinationals—Apple Inc., AAPL - 0.76% Starbucks Corp. SBUX +0.23% and Fiat F.MI +1.29% SpA—in a move that experts said was aimed at deterring companies from aggressive tax planning.

The commission is examining whether individual tax deals struck by Apple in Ireland, Fiat Finance and Trade in Luxembourg and Starbucks in the Netherlands amounted to illegal aid from the governments to the companies. The companies could be forced to pay back any illegal aid.

Joaquín Almunia, the EU's competition commissioner, said at the time that it was unacceptable "that large multinationals do not pay their fair share in taxes." He said the investigation could range much wider, and that his agency has also requested information from the U.K. and Belgium.

The move came after earlier efforts by EU governments to crack down on tax avoidance and tax evasion made painfully slow progress and yielded little. Despite high-profile hand-wringing by some politicians over Ireland's low corporate tax rate, tax policy remains largely in the hands of national governments, which can veto EU decisions.

In a report accompanying the new OECD guidelines, the 44 governments said they had decided not to pursue new rules designed specifically for digital companies.

"Because the digital economy is increasingly becoming the economy itself, it would be difficult, if not impossible, to ring-fence the digital economy from the rest of the economy for tax purposes," the OECD said.

The Irish government said it welcomed that conclusion. Ireland hosts the international operations of a number of U.S. digital giants, and has been among a small number of countries that have faced allegations that their tax codes facilitate questionable tax-planning practices by international firms. But the Irish government has vehemently denied that the country can be characterized as a tax haven.

—Tom Fairless contributed to this article

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