

# We still haven't found what we're looking for:

## why global efforts to tackle tax avoidance will not work for developing countries

*'...the tax practices of some multinational companies have become more aggressive over time...The international common principles... may not have kept pace with the changing business environment.'*

OECD, 'Addressing Base Erosion and Profit Shifting', 2013

*'Developing countries should be able to reap the benefits of a more transparent international tax system.'*

G20 leaders Declaration, September 2013

### The clash over cash: financing sustainable development

Tax is a hot topic for those engaged in tackling global poverty, and it is easy to understand why. In 2008 Christian Aid estimated that developing countries (including large emerging economies) were losing as much as US\$160bn each year through tax dodging by multinational companies and other businesses engaged in international trade – more than they receive in aid.<sup>1</sup> This figure is disputed by some (the secretive nature of tax avoidance means we can only estimate), but various attempts made since to gauge the size of the problem all agree it is significant, and suggest our figure is unlikely to be too wide of the mark.

This is money the developing world can ill afford to lose. In September next year the United Nations aims to agree a set of global 'Sustainable Development Goals' (SDGs) to replace the current 'Millennium Development Goals' (MDGs). As ActionAid recently pointed out, the most crucial question with regard to the original MDGs – how the goals would be paid for – was barely asked, or even acknowledged, during the original negotiations.<sup>2</sup> And it has never been fully answered in the fourteen years since. Costs were underestimated. Commitments were insufficient. Promises were broken.

The historical failure to consider financing in a realistic way creates a worrying backdrop to the SDG negotiations. To avoid such an oversight this time around, the G77 group of developing

countries has demanded that nothing should be agreed without it being clear how it will be paid for.<sup>3</sup>

Clear, and unequivocal, commitments on finance must therefore be in place if an ambitious set of goals are to be agreed; the bill will be huge, running to trillions of dollars according to the International Committee of Experts on Sustainable Development Finance (ICESDF).<sup>4</sup>

The difficulty is that current levels of public and private investment come nowhere close to these amounts. The United Nations Conference on Trade and Development (UNCTAD) indicated recently that there will be a shortfall of some US\$2.5tn a year in terms of finance for developing countries.<sup>5</sup>

There is no magic bullet to solve this. Traditional development aid will never deliver this kind of money, and nor should it. Enlightened aid in this day and age, as outlined in the recent ActionAid report *'Real Aid'*, is about helping countries lift themselves out of aid dependency.<sup>6</sup> The global fight against poverty and inequality can no longer be about old fashioned, outdated, ideas of 'donors' and 'recipients'. All countries will need to play a part in reforming the global economy to create a fairer, more transparent and more accountable system. This must include giving governments in the developing world the opportunity and capacity to raise their own revenues through increased economic activity coupled with effective taxation.

**‘Developing countries should be able to reap the benefits of a more transparent international tax system and to enhance their revenue capacity’**

**Fixing the broken tax system: the G20 and OECD ride to the rescue**

During the run up to the G8 summit in Northern Ireland in 2013, a coalition of some 200 UK-based organisations united behind the IF campaign to push for strong commitments on development from the leaders of the world’s most powerful group of nations.<sup>7</sup> Alongside familiar demands for more and better aid, land rights and transparency, a new issue was now in the mix: taxation. Wholesale reform was needed, said the campaign, to help poor countries fight tax dodging and claim the taxes owed to them by multinational companies making use of such secrecy jurisdictions to hide profits and minimise their tax liabilities. This focus on tax reflected a growing awareness by development NGOs of the potential it holds for sustainable, long term, development. Mirroring that trend has been a domestic movement spearheaded by direct action groups such as UK Uncut, reacting to government cuts and austerity measures by demanding an end to tax dodging by large companies and rich individuals.

Governments started listening. In response to these growing pressures, both the G8 and the G20 had, a year before the Northern Ireland summit, mandated the Organisation for Economic Co-operation and Development (OECD) to prepare an action plan aimed at tackling the tax dodges used by multinational companies, and other businesses trading across borders.<sup>8</sup>

The abuse is opaquely dubbed ‘Base Erosion and Profit Shifting’ by the OECD, or BEPS for short. ‘BEPS’ is simply a catch-all phrase that refers to a variety of strategies used by multinational companies to exploit the gaps and differences in tax rules between different countries. Such strategies have the effect of either making profits ‘disappear’ (so that no tax is legally owed) or of moving profits to locations where the company may have little or no real activity but where taxes are low. Either way, the end result is little or no overall corporate tax being paid.

In drawing up its action plan, the OECD said it recognised that tax rules had not kept pace with globalisation and the changing nature of multinational companies; an acknowledgement, in effect, that the present global tax system is not fit for purpose.

The OECD plan sets out 15 actions to be delivered within two years. The mere fact that the plan exists should be seen as a major step forward. It represents a long overdue acceptance that the status quo cannot be maintained. It signals a shift in thinking from an overwhelming obsession with avoiding ‘double taxation’ (the risk that a company may be taxed twice for the same thing) to the recognition that double non-taxation (where a company is able to pay no tax at all) represents an equal, or even greater, risk, especially for poorer countries.

Endorsing the OECD’s efforts, G20 leaders said they expected that

‘developing countries should be able to reap the benefits of a more transparent international tax system and to enhance their revenue capacity’.<sup>9</sup>

The UK Government has also explicitly stated that it expects the plan

‘to encourage fairness, both between developed and developing countries, between domestic and international businesses, and between UK-based and foreign-based international businesses’.<sup>10</sup>

**Niggling doubts**

Based on such sentiments, expectations have been running high that real change is in the offing. But Christian Aid and more than 30 other concerned organisations recognised from the outset that such optimism would be misplaced unless some key shortcomings were addressed.<sup>11</sup> In particular, we called on the OECD and G20 to:

- ensure that developing countries can participate on an equal footing
- recommend and support a strengthening of the existing UN Tax Committee to enable it to play a stronger role in the OECD process, and especially to bring the views of developing countries into the discussions<sup>12</sup>
- ensure that the impacts on developing countries of any agreed actions are well understood and communicated
- work with other bodies to examine options for systemic change, that go beyond just making existing principles work better
- ensure that parallel processes to the BEPS project are undertaken to tackle financial secrecy.

Many developing countries have also voiced their concerns about the BEPS action process, claiming that it is not doing enough to fundamentally reform the international tax system and that it is failing to incorporate the concerns and interests of developing countries. At a recent conference of finance ministers from low-income Francophone countries, participants noted the need for a fundamental reform of the international tax system, stating that the OECD process is not addressing the needs of their countries and that the cause of these problems is 'the lack of decision making power for LICs [low-income countries] in global tax discussions... LICs need an equal seat at the table...' <sup>13</sup>

### **The half time scores are in...**

As the OECD nears the end of its first year of work on the project, it has released reports and recommendations on seven of the BEPS project action points. These do not necessarily represent the final outcomes, but they do provide a strong indication of how things are developing, and what might ultimately be expected. We can judge the process so far against two main criteria:

1. Has the process been adequate in terms of inclusion, transparency and accountability?
2. Will the outcomes, as announced so far, be likely to benefit developing countries?

On the first, the BEPS project does include some larger emerging economies such as South Africa, Brazil, India and China on an equal basis, since they are members of the G20. However, these countries do not necessarily share a similar agenda to low-income countries (LICs). The OECD held a series of regional consultations with LICs, to learn first-hand of their priorities and concerns, reporting subsequently to the G20's 'Development Working Group' on how the matters raised related to the action plan. <sup>14</sup>

However, the concerns raised by developing countries have been sidelined, and the BEPS Action Plan remains unchanged. In September 2014, the G20 Finance Ministers demanded greater inclusion of developing countries into the BEPS process, <sup>15</sup> but the BEPS Action Plan continues to move forward, full steam ahead on its pre-existing agenda. As a result, this push for inclusion is too little too late and the whole exercise has only served to highlight the fact that the process is failing the poorest countries in three key ways:

1. **It is not designed in their interests.** OECD themselves admit that 'the risks faced by many developing countries may differ from those faced by more advanced economies'. For their part, developing countries say the action plan fails to address a number of their key concerns.
2. **It fails to ensure appropriate representation and accountability.** The OECD was set up as, and remains, a 'rich countries club'. LICs are not members. Consultations on the sidelines cannot compensate for the lack of opportunity to participate in the process on an equal footing. The lack of access for developing countries, combined with heavy corporate lobbying, ensures that the outcomes cannot be considered balanced and legitimate in shaping the future of international tax rules.
3. **Speed of progress has been skewed in favour of those actions most relevant to richer countries.** Progress has not been consistent across the seven action points. Our analysis overleaf shows a clear pattern of processes moving faster when they are seen to be in the interest of richer countries, and slowing to a crawl when they may present a perceived risk to large corporations and the rich countries in which these corporations are resident.

## The BEPS Scorecard: analysing progress from a development perspective

Of the seven action points so far tackled, some have greater relevance to developing countries than others. In each case, there could have been potential for the suggested solutions to work in favour of developing countries. In most, the opportunity appears lost.

BEPS Action	Problem analysis	OECD report/recommendation	Analysis/rating
<b>Dealing with the digital economy</b>	<p>With the shift towards 'digital business models', businesses can now market goods and provide services (including to developing countries) in a country without having any significant physical office or staff.</p> <p>Since the current rules require a physical presence, a 'Permanent Establishment' (PE) for countries to tax profits, multinational businesses can avoid tax while generating profits through their digital operations.</p>	<p>The OECD has, correctly, recognised that solutions need to deal with the core problem and not just deal with few iconic targets. It is committed to a re-examination of how a PE is defined.</p>	<p>The OECD has made progress on this issue, but it has still not been honest enough about the inadequacy of the international tax system to address the current economic reality.</p> <p>Key discussions on re-defining and expanding definitions of a PE should include the perspectives of poorer countries with a major stake in the outcomes. But so far it is far from clear how this would happen.</p>
<b>Neutralising hybrid mismatches</b>	<p>Hybrid mismatches allow multinational companies to take advantage of different tax rules in different jurisdictions in order to avoid tax. Such avoidance requires sophisticated tax planning at the global level.</p>	<p>The OECD has made quite a bit of progress in developing, and reaching consensus on recommendations for rules that, if implemented correctly, could help prevent hybrid mismatch arrangements.</p>	<p>The hybrid mismatch rules from the OECD are highly complex. Such rules are conceived by, and created for, developed nations (and their multinational companies). They lack the serious input from poorer countries, which could have led to more practical approaches to taxing global companies.</p>
<b>Tackling harmful tax practices</b>	<p>Harmful tax practices are where one country puts in place tax rules that may have a negative impact on the tax revenues of another country.</p> <p>This is an issue that the OECD has been trying to work on for almost two decades, without much progress. Successful action in this area has huge potential for the incomes of developing countries' governments.</p>	<p>The OECD proposes to continue a peer-review mechanism, depending on self-reporting to identify potentially harmful practices.</p> <p>Discussions (held behind closed doors) on the substance of what actually constitutes a 'harmful' tax practice – have been blocked by group of countries, including the UK, with a specific interest in certain types of potentially harmful tax tool – the 'innovation (or patent) box'.</p>	<p>This is a major opportunity lost for development, largely as a result of vested interests in the status quo winning out against proposals for change.</p> <p>The fact that discussions in such a critical area were held behind closed doors does not reflect well on the transparency of the OECD process overall.</p>
<b>Preventing treaty abuse</b>	<p>Tax treaties generally restrict the power of many poorer countries to tax profits earned from their own country, especially when those profits are taken out of the country. Multinational companies often reduce tax bills by directing profits through a shell company in a third country to take advantage of better tax breaks written into treaties.</p>	<p>The OECD recommended several options to help solve this problem, but no consensus was reached on the best approach.</p>	<p>Some of the OECD's suggested revisions represent a step in the right direction.</p> <p>However, it remains unclear as to how accessible such options will be for poorer countries.</p>

BEPS Action	Problem analysis	OECD report/recommendation	Analysis/rating
<b>Dealing with intangibles in transfer pricing</b>	<p>Much global trade takes place between companies that are part of the same global group. Under the current system such transactions must be comparable with similar transactions between companies that aren't related. But some things (such as branding rights or services) are just not easy to value in this way. These are known as 'intangibles' and since some intangibles can be located practically anywhere and priced almost as a company sees fit, the tax avoidance possibilities are endless.</p>	<p>The OECD has delivered proposed new guidelines to clarify what counts as an 'intangible' and to provide methods for valuing intangibles.</p> <p>There is a good deal more work to be done in this area including work on simpler ways of valuing transactions of intangibles. So far however, the proposals look likely to add to, rather than reduce, the complexity in this area.</p>	<p>The OECD had an opportunity to provide some significant progress, of real value through this work on intangibles. But so far it has resolutely gone in the opposite direction by adding layer upon layer to the complexity of rules instead of finding clear and simple solutions that work universally.</p> <p>Good news for tax advisers, but less so for poorer countries, which lack the resources to enforce complex rules that require global companies to pay their fair share of tax.</p>
<b>Country-by-country reporting</b>	<p>At present most companies simply provide a single consolidated report for their whole global operation, meaning that tax administrations are unable to determine where the company holds assets or employs people or generates revenue. This makes it impossible to assess whether or not their taxable profits are geographically aligned with economic activity and value creation.</p>	<p>The OECD has agreed on a reporting scheme that requires multinational companies to provide information to national tax administrations in each country where they operate, including the taxes due and paid, total profits, number of employees and total assets (known as 'country-by-country' reporting).</p> <p>However, it is not proposed that any of this information would be placed in the public domain despite the fact that public country-by-country reporting has already been agreed for the financial sector in the European Union and is under active discussion more widely.</p>	<p>In principle the information required under the scheme proposed would go a long way to understanding whether a company was engaging in profit shifting and it must therefore be seen as a step forward. However the failure even to discuss the possibility of putting the reports in the public domain limits the potential value and is indicative of the overall dynamic within the OECD process, with resistance coming through strong private sector lobbying.</p>
<b>Developing a multilateral treaty</b>	<p>This final action in the BEPS plan involves taking the recommendations and integrating them into treaties between countries.</p>	<p>The OECD has proposed the development of a single, multilateral 'super treaty' to encompass all the various changes agreed by OECD and G20 countries. The report concludes that this kind of multilateral treaty is both desirable and feasible.</p>	<p>This 'super treaty' presents an unprecedented opportunity for the OECD and the G20 to open the process for genuine influence by developing countries. At this point, however, the process has already excluded the primary concerns of developing countries and it is very far from clear that there is the will, or desire, to re-open the process and give non-OECD and non-G20 countries the opportunity to influence the final package before joining.</p> <p>It seems most likely that poor countries will be provided with a <i>fait accompli</i> and put under pressure to sign up or risk exclusion from the global economy.</p>

## Conclusions and recommendations

- Many reforms proposed so far are of limited benefit to developing countries. Those aspects of the action plan with the greatest potential benefit for developing countries seem to have moved particularly slowly, while some issues that have been identified as being of key importance by developing countries are not included at all.
- Despite the regional consultations, the process is deeply undemocratic, with developing countries excluded from engaging on an equal basis, despite the fact that they have the most to lose or gain.
- The analysis has not been ambitious enough, failing to look beyond the core principles of the current system and consider if and how more fundamental changes may be implemented in favour of poorer countries.
- Evidence would suggest that the progress so far has been influenced by the interests of richer, and more powerful countries, and the large companies that they host, over the interests of poor countries
- Within the BEPS process going forward, more can be done to improve the outcomes for developing countries. More effective and open engagement with developing country governments and civil society, a focus on priority sectors such as extractives and agriculture and a stronger focus on specific approaches that developing countries can use to overcome transfer mispricing would all be helpful. G20 leaders can provide a clear statement, committing them to ending 'beggar-thy-neighbour' tax practices, providing low tax rates for multinationals and promoting a global race to the bottom on corporate tax rates.
- However, more consultations will not fix the core of problem, which is that the OECD is not a globally inclusive body, and the BEPS action plan has not been designed with developing countries in mind. An entirely new process is needed which is more responsive to the needs of the poorest countries, and it should be fully inclusive and fully transparent.
- This process should take place within an intergovernmental body which is fully representative and fully inclusive.

## Endnotes

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12. The UN tax committee is an expert group within the UN that includes developing country representation and seeks to provide recommendations on how countries can better work together ensure a fairer and more effective tax system. However it is desperately under resourced, and has a limited mandate, which restricts its effectiveness.
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We work globally for profound change that eradicates the causes of poverty, striving to achieve equality, dignity and freedom for all, regardless of faith or nationality. We are part of a wider movement for social justice.

We provide urgent, practical and effective assistance where need is great, tackling the effects of poverty as well as its root causes.

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