Tackling tax avoidance by multinationals

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# Context: multinationals in the political spotlight

- Significant political action in the UK
  - Prominent interventions by Public Accounts Committee in last few years
  - Numerous UK Corporate tax policies over the last 5 years
  - Business roadmap to be released with the Budget

- OECD Base Erosion and Profit Shifting (BEPS) project completed in October 2015
  - A large multilateral attempt to update the international tax rules

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How big is the problem?

Google | tax avoidance | 🔍

- *'bending the rules of the tax system to gain a tax advantage that Parliament never intended...operating within the letter – but not the spirit – of the law'*

- Hard to know the scale of avoidance

- OECD estimate avoidance cost at between $100 billion-$250 billion worldwide: 4-10% of global corporate income tax revenues

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Corporate tax receipts % GDP, 1979–2014
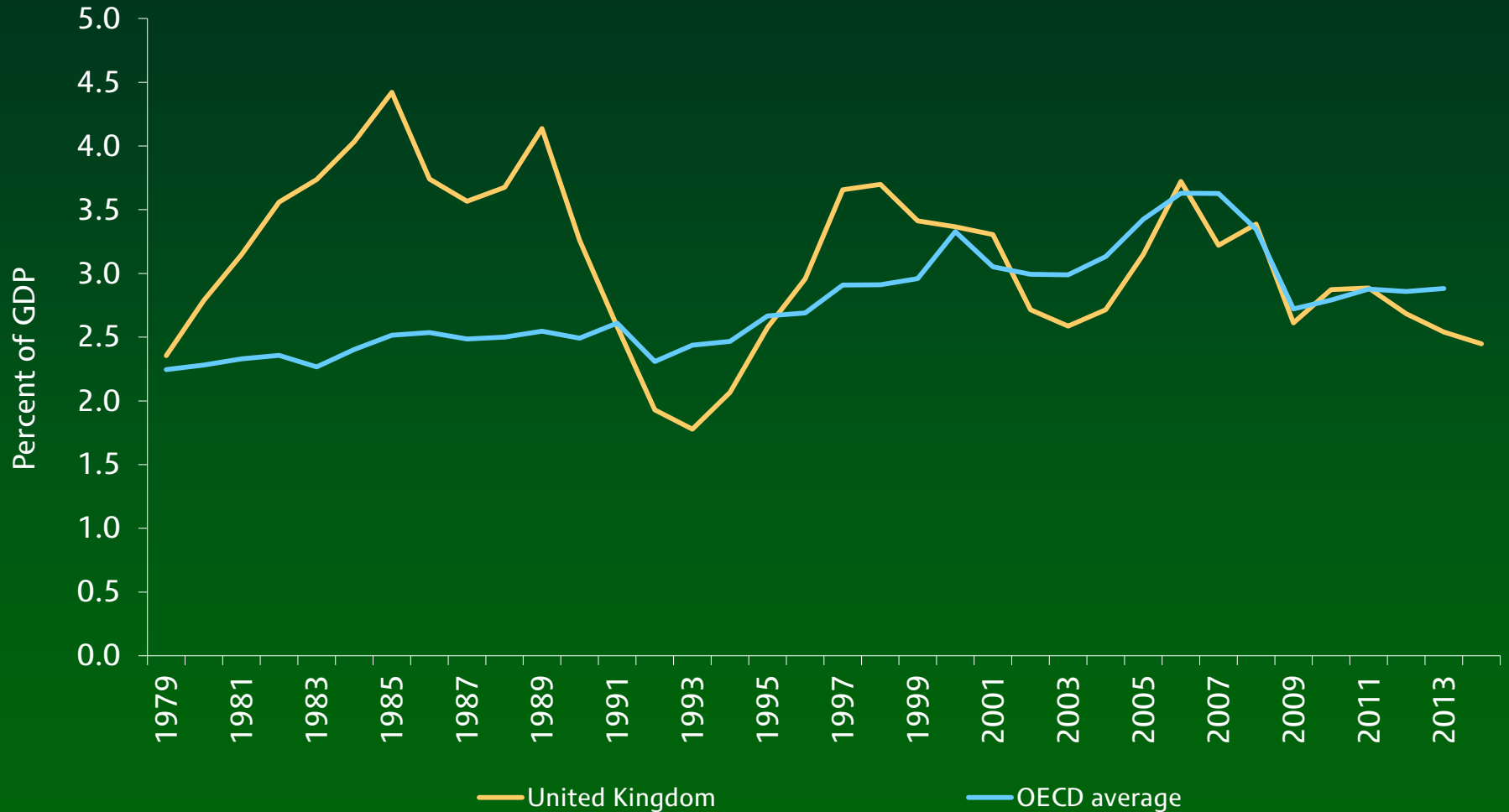
Notes and sources: See Figure 8.2 of Green Budget document

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How do we tax multinational companies? (1)

- We need to divide profits between different jurisdictions

- The system does not try to tax profit based on sales

- The principle of the international tax system is that we should tax profits *at source*; where the value is created

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How do we tax multinational companies? (2)

Pharmaceutical drugs

Ideas

Transfer price

£ £

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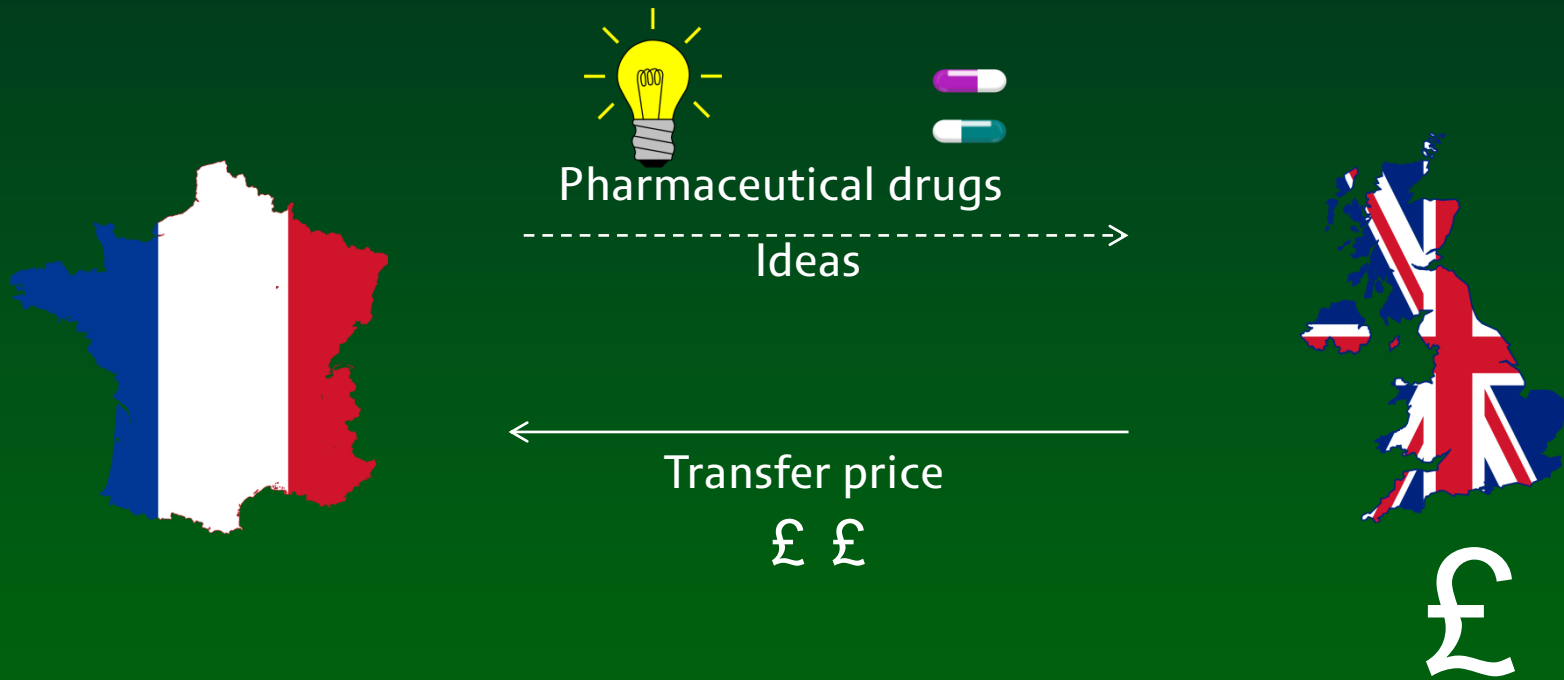
How do we tax multinational companies? (3)

- Note that this system, even when applied perfectly, can lead to:
  - Large sales and low tax payments
  - Large reported profits in low tax jurisdictions

- However, in practice there are avoidance opportunities
  - Hard to calculate transfer prices
  - Other difficulties arise at the boundaries between tax systems

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OECD Base Erosion and Profit Shifting (BEPS) project

- 2 year multilateral attempt to improve the international tax system, relying on international consensus

- Addressed 15 'action points' looking at different elements of the rules. Either:

  - Changes that all countries have agreed to enact (eg transfer prices)

  - OR recommended changes that governments can choose to follow

- Next: implementation

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Improvements for the UK

- Country by country reporting will help countries target resources
  - But it won't mean avoidance can always be identified
- Changes to the definition of taxable presence in tax treaties
  - While it 'moves the goalposts' the incentive to cheat it remains
- UK to implement 'anti-hybrid' rule from 2017
  - Though as a recommended best practice it won't be implemented everywhere
- Patent boxes to be modified by July 2016 to be more closely linked to real activity
  - The patent box remains a poorly targeted innovation policy

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George's big BEPS decision – interest deductibility

- Many countries, including the UK, have rules to restrict interest deductibility

- UK has consulted on a change to interest deductibility, announcement expected at the budget

- OECD rule would restrict interest deducted to a proportion of operating profit

- A more stringent rule than the current UK provision

- Tradeoff between preventing avoidance and distorting genuine activity

- Especially for business models that include large amounts of debt

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The incentive to compete – the elephant in the room?

- Second tradeoff: between preventing avoidance and maintaining competitiveness

'The UK's current interest rules, which do not significantly restrict relief for interest, are considered by businesses as a competitive advantage'. Corporate tax roadmap, 2010

- *Minimum standard* vs *recommendation:* countries unwilling to sacrifice competitive advantage

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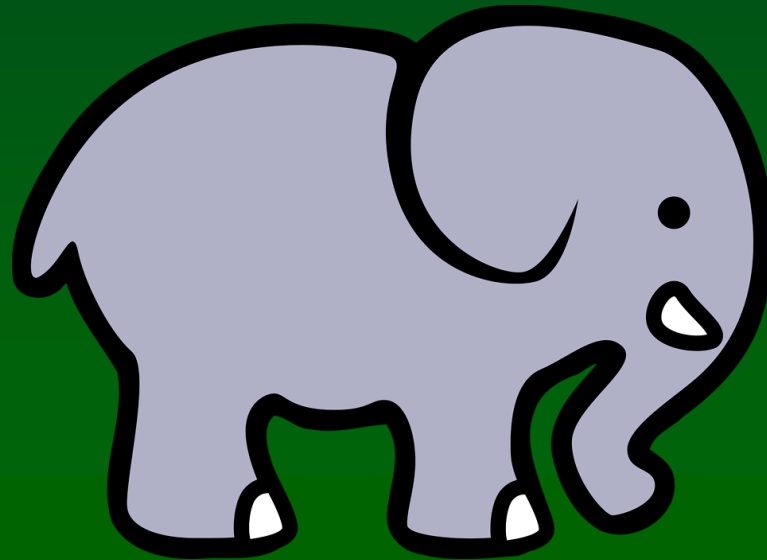
Summary: where do we go from here?

- The BEPS process is an impressive project, but is not a silver bullet

- Underlying problems remain unaddressed

- Only time will tell how effective these measures will be

- Countries face a trade-off between competition and collaboration

- Uncertain effect on UK revenues

- EC published anti-avoidance plan on 28th January 2016

- Depending on how effective these measures prove, we may want to consider more radical changes, eg allocate profits based on location of sales

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