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
How big is the problem?

• ‘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
Corporate tax receipts % GDP, 1979–2014

Notes and sources: See Figure 8.2 of Green Budget document
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
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
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
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
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
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
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