June x, 2014

Dear (Member of the OECD Committee on Fiscal Affairs):

Re: Civil Society Perspectives on the G20/OECD BEPS process to date

We write to you as an organization/ organizations which has been following the OECD BEPS project and related processes to reform international tax rules. We would like to take this opportunity to convey our viewpoints and expectations on the G20/OECD BEPS process to date.

The content of this letter is based on the ongoing analysis of the 'BEPS Monitoring Group' (BMG), a network of specialists on international taxation, concerned with the effects of international taxation on development and supported by a number of tax justice organizations. The views expressed in this letter are also endorsed by the Coordinating Committee of the Global Alliance for Tax Justice, a formal network of 81 NGOs from 37 countries campaigning together on Tax Justice) the letter contains our general concerns and expectations on the BEPS process and approach. We also attach an Annex with specific comments on each OECD 2014 Deliverable.

We believe that the BEPS process should be inclusive. We recognize the efforts of the OECD in implementing the BEPS agenda under strict deadlines, and have welcomed the opportunity to provide comments and attend consultations on some of the BEPS Action Plan points. Nevertheless, we believe that the process has serious limitations which could jeopardize a successful conclusion, for two main reasons.

First is the lack of equal representation from all countries, including non-G20 countries, both in the early agenda development as well as the execution. Without the opportunity to identify the specific challenges and potential solutions for genuine reform, the regional and other consultations have served as orientations to a pre-existing plan. Moreover, although developing country concerns have been noted by the OECD, this participation has appeared to have been sidelined out of the BEPS process and into the domain of the Development Working Group.

Second is the domination of consultation processes at both national and OECD levels by tax advisers. The OECD itself has made greater efforts to include a wider range of civil society representatives in the consultation processes than have most of its members. Nevertheless, this falls far short of the parity between business and civil society that we suggest should be the aim. We are concerned at the close connections which have developed over the past period between OECD personnel and the tax planning industry, evidenced by the `revolving door' which has seen many OECD officials take up posts with tax advisory firms, and some moving in the reverse direction. Greater efforts should be made to make the discussions accessible to a wider range of stakeholders and to take more seriously perspectives which have until now been regarded as unorthodox by the OECD. It is also regrettable that not all the Action points have been opened for public comment.

We also believe that the BEPS policy scope should be wider. The Action Plan does not suggest any re-examination of the basic principles of the system, but is restricted to actions aimed at making the existing rules more effective. The OECD has made it clear that it is beyond the scope of the BEPS project to try to deal with certain key issues that have been identified as being of importance by civil society and developing country governments. These include the principles of allocation of tax rights between residence and source countries; alternatives to tax base allocation under a separate entity approach through the arm's length principle; or the use of tax incentives to attract foreign direct investment. Furthermore, the BEPS project will not explore more practical measures, such as the use of withholding taxes, presumptive regimes, or greater use of profit-split rules which may be more suitable for developing countries in preventing erosion of their tax base. . Although this may seem to be a necessary economy of effort, we fear that it will hinder the chances of achieving the comprehensive and effective reforms which are needed, and which could command wide acceptance.

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Annex: Specific concerns on 2014 Deliverables:

1. Action 1: Address the tax challenges of the digital economy:

As outlined in the OECD's discussion draft on the digital economy, the digitalization of the economy has created a new economic environment, which requires new thinking for tax system design. In the digitalized economy, the core activities that businesses carry out as part of a business model to generate profits have changed and as a result, traditional understandings of value creation between businesses and consumers are inadequate. Moreover, information and communication technology innovations have enabled connectivity and expanded business reach. For these reasons, we believe that nexus issues and the value of consumer data and network effects must be re-examined in light of the entire BEPS agenda. We are disturbed by statements made by members of the digital economy task force that analysis of this central issue could be delayed until further work is done under other action items. A proper understanding of the business environment is foundational to prudent tax system design.

Therefore, we urge the CFA to:

- acknowledge the need for further work on Action Item #1 in order to properly address Action Items 2-15;
- push for adoption of a Significant Presence concept of permanent establishment and eliminate exemptions for auxiliary and preparatory functions; and
- acknowledge the value of consumer generated content and data in tax system design.

2. Action 2: Neutralise the effects of hybrid mismatch arrangements (HMAs):

The underlying cause of the problems of BEPS is the 'separate entity' principle in tax treaties. This incentivises multinational corporate groups to develop complex structures using entities in suitable jurisdictions to hold assets and route payment flows in ways that minimise their overall global tax exposure. Many of the proposals now being developed in the Action Plan will result in the elaboration of complex rules attempting to deal with different aspects of the problem. The response of tax planners will undoubtedly be to devise increasingly complex structures aiming to avoid those rules. Tax rules, like any regulatory arrangements, can only be effective on a sustainable basis if they work with the grain of the economic motivations of the persons whose conduct is being regulated, and not against it. This is especially important for finance, since multinational corporate groups decide centrally on how to raise capital on global capital markets, while devising complex structures internally for the allocation and management of their funds using intermediary entities. The use of hybrid entities and instruments are amongst these techniques. In our view, the proposals that were put forward in the discussion draft, while elegant and astute, were also complex and would require careful coordination. As was clear from the consultation, they were over-inclusive in applying also to unrelated parties, yet related parties in multinational groups would be able to devise new techniques to avoid them, as has been the experience in countries that have already adopted similar approaches. In our view, it is time to consider alternatives, including the option of treating group debt on a consolidated basis and apportion it among the operating entities. This could deal with both HMAs and other Action Plan points such as interest deductibility, the use of conduits and transfer pricing of debt. It would also

be simpler and easier to administer, which is especially important for tax administrations in developing countries.

Therefore, we urge the CFA to:

- consider new approaches, including apportionment of consolidated debt to deal with both HMAs and similar BEPS techniques.

3. Action 5: Counter Harmful Tax Practices more effectively taking account of transparency and substance:

We regret that there has been no public consultation or discussion on this point, which is very important to the Action Plan, so we would like to make three points. First, fairness in taxation clearly requires full transparency of all tax rulings, including Advance Price Agreements (APAs) and decisions in Mutual Agreement Procedures (MAP), indeed in our view they should normally be published. Secondly, the criterion of substance is also central to ending harmful tax competition. We are concerned that some countries, as well as tax advisers, consider that it might be satisfied by requiring entities to be more than brass plates only by having a physical office and a few employees. In our view the test of substance should be whether the income attributed to an entity is proportionate to the real economic activities it undertakes. Thirdly, we are also concerned that this Action point might result in legitimising the granting of low tax rates for profits supposedly attributed to research or innovation activities. Theory and practice show that innovation is a continuous and interactive process, and that ideas and inventions only have value if developed into actual marketable products, which is a far more expensive process. Allowing countries to grant low tax rates for profits supposedly attributable to intellectual property rights, while deductions for expensive product development and testing are attributed elsewhere, would be a recipe for BEPS. Countries which wish to support science and innovation can do so adequately through tax allowances and deductions for actual expenditure.

4. Action 6: Prevent treaty abuse:

In our view, both the OECD Model and the proposed Multilateral Convention should include a core provision making it clear that tax treaties aim to prevent both double taxation and double non-taxation. This provision should take the form of a substantive article with the wording from the St. Petersburg Declaration: "The object and purpose of this treaty are to ensure that profits are taxed where economic activities occur and value is created." This would be broader than a main purpose provision, and would not conflict with more targeted provisions such as a Limitation-on-benefits (LoB) provision. We therefore further support the inclusion of a LoB clause as an effective instrument to mitigate tax treaty abuse under current rules in conduit transactions. In our view both these provisions should be included in the multilateral Convention under consideration by the Expert Group under Action Point 15. In view of the importance of these provisions as well other BEPS reforms for developing countries, we would expect such a multilateral convention to be open to accession by all countries without any preconditions.

Therefore, we urge the CFA to:

- approve an object and purpose clause based on the St Petersburg Declaration;
- appove a Limitation of Benefits clause;
- recommend the inclusion of these provisions in the proposed multilateral convention.

5. Action 8: Assure that transfer pricing outcomes are in line with value creation - intangibles Phase 1:

The use of comparables in establishing standards for transfer prices under the arm's length principle has been shown to be deficient in both theory and practice, due to the integrated nature of multinational firms and their advantages of superior know-how and technology, and economies of scale and scope. The proposals in the discussion draft on Intangibles were a long-overdue recognition of the need to move away from the fictions of ownership, contract and provision of capital to justify transfers within multinational corporate groups, which have long been a primary source of BEPS. The draft implicitly, and at some points explicitly, accepted the unsuitability of methods based on comparable prices or profits, suggesting a shift towards profit split. However, this was not made clear in the wording of the draft. Furthermore, it made no attempt to improve the profit split method by proposing methods to combine the related party profits, nor suitable allocation keys. Unless this method can be systematised it will continue to be highly arbitrary and a cause of conflict. We were also disappointed and concerned that the report on *Transfer Pricing Comparability Data and Developing Countries;*also produced by the OECD, largely disregarded the known problems with comparables, failed to evaluate adequately the suitability of the data in the data-bases the use of which it advocated, and gave insufficient weight to more practical methods adopted by some developing and emerging countries.

Therefore, we urge the CFA to:

- make clear the unsuitability of both comparable price and comparable profit methods especially in relation to intangibles;
- ensure the inclusion of proposals to explore the profit split method, such as suitable methods of defining the combined profits to be split and appropriate allocation keys;
- ensure that developing countries are no longer recommended to apply methods based on comparables which are illusory and ineffective as well as requiring excessive use of scarce skilled resources, and advised instead to develop methods which are attuned to business reality and easier to administer.

6. Action 13: Re-examine transfer pricing documentation and develop a template for country-by-country reporting

In our view, it was a mistake to confuse the mandate to develop a template for a Country-by-Country Report (CbCR) with transfer pricing documentation. The CbCR should be an essential tool for evaluating all BEPS issues and risks and not only transfer pricing. In our view, the CbCR should include (i) the worldwide consolidated accounts of each multinational corporate group eliminating the effects of internal transfers, the aggregate accounts of its component entities in each country, and a reconciliation of the two; (ii) data on the employees (by physical location and including both headcount and payroll costs), sales (by destination), and taxes both due and

paid. This should be regarded as distinct from especially the Transfer Pricing Documentation Local File. Although we appreciate the need for commercial confidentiality we see no reason why the high level information in the CbCR now proposed should be regarded as commercially confidential, except perhaps in exceptional circumstances. Separation of the CbCR from Transfer Pricing Documentation requirements should enable it to be made clear that the CbCR is not regarded as including information that is commercially confidential. For exceptional cases, a procedure could be considered whereby individual taxpayers would have the possibility to give reasons for confidentiality in those specific cases. We would be very concerned if the mere fact that the CbCR is supplied to tax authorities should create an assumption that the information it includes is necessarily confidential. This would be entirely against the spirit of the G20 mandate to design a CbCR template for tax transparency. Finally, the preparation of both the CbCR and any Transfer Pricing Documentation should be the responsibility of the parent company of an MNC group, which should however ensure that they are transmitted directly to the tax authorities in every country where it has a taxable presence. Transmission via treaty mechanisms has proven to be a very difficult and ineffective approach, which also creates risks of political conditions and restrictions on information sharing between countries. Such an approach would create unnecessary obstacles for governments to access CbCR information, especially for developing countries.

Therefore, we urge the CFA to:

- approve a CbCR template which can provide an overview of the consolidated profits of a multinational corporate group and data on its profits, taxes due, taxes paid, employees and sales in each country, distinct from transfer pricing documentation requirements;
- make it clear that the information required by the CbCR template should normally be made public
- ensure that requirements to supply information which could be regarded as commercially confidential are limited to the Transfer Pricing Local File;
- ensure that the obligation to prepare all information is on the parent company but that it should be supplied directly to every country in which it has a taxable presence.

7. Action 15 Develop a multilateral instrument.

We hope that there will be an opportunity to comment and debate the proposed instrument following the initial report of the Expert Group. A number of both technical and political issues need to be carefully considered, especially that of ensuring that all states are able to participate in the development of the eventual instrument on an equal footing, and have equal possibilities of participation in the final instrument. .

Concluding Remarks

We are concerned that the OECD's patch-up approach will result only in rules and arrangements which will be much more complex and require careful coordination to be effective, and would only provide opportunities for 'tax planning'. In our view, such a 'patching up' of the existing dysfunctional system will not lead to the fulfillment of the G20's mandate to ensure that profits are taxed `where economic activities take place and value is created'. We believe that it is time to

consider options for removing the incentive for BEPS techniques by explicitly reversing the separate entity principle and replacing it with a unitary principle. This does not mean introducing a fully-fledged system of formulary apportionment immediately. Recognition that multinationals are unitary firms could lead to reforms such as the strengthening of profit split, the treatment of debt on a consolidated basis, and other methods for apportionment of joint and overhead costs such as central management. This would help ensure that reforms would be coherent and comprehensive, and effectively fulfill the G20's mandate to ensure that profits are taxed `where economic activities take place and value is created'

ENDS.