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Policy Forum: Editors' Introduction—Addressing Base Erosion and Profit Shifting

On February 12, 2013, the Organisation for Economic Co-operation and Development (OECD) released a report on the subject of base erosion and profit shifting (BEPS) by multinational enterprises (MNEs).[1] The reduction of this important subject to yet another tax acronym may not end up as the only—admittedly trivial—result of the ambitious policy project that the OECD has initiated. The report provides a general discussion of a range of issues associated with BEPS, and its significance at a general level probably lies in the signal it sends that the OECD is willing to undertake a serious reconsideration of many of the features of the current international tax regime that have resulted in very low levels of tax payable by MNEs from their cross-border operations. In fact, the OECD's commitment to the BEPS project was made clear in a detailed action plan released on July 19, 2013.[2] The plan describes 15 different areas of study, with each one being assigned to an OECD working group established for this sole purpose. Relatively short timelines are provided for the release of discussion drafts by these working groups as the basis for consultation, and by the spring of 2014, the process was well advanced in some areas.

We believe it is not an overstatement to suggest that the BEPS project is one of the most ambitious and potentially significant tax policy projects undertaken recently by the OECD. As with all OECD initiatives, realization of tangible results will ultimately depend on the response of national policy makers and member governments. It is notable that some countries have already acted unilaterally with limited initiatives in advance of completion of the BEPS project. In this respect, Canada's Department of Finance released proposals addressing treaty shopping in the February 11, 2014 federal budget.[3] The budget announcement also invited input from stakeholders on issues related to international tax planning by MNEs.[4] The apparent intention is to use this input to help guide the federal government's participation in the BEPS project.

1 Organisation for Economic Co-operation and Development, *Addressing Base Erosion and Profit Shifting* (Paris: OECD, 2013).

2 Organisation for Economic Co-operation and Development, *Action Plan on Base Erosion and Profit Shifting* (Paris: OECD, 2013).

3 Canada, Department of Finance, 2014 Budget, Budget Plan, February 11, 2014, at 349-57.

4 Ibid., at 347-49.

It is probably not just a coincidence that the BEPS project was initiated by the OECD after the public spotlight had been focused by civil society and tax justice organizations on the cross-border tax planning engaged in by a number of prominent MNEs to drastically reduce their tax liability. Not surprisingly, this became a highly charged political issue in the wake of the financial crisis of 2007-2009 and the revenue imperative it created. Following high-profile hearings in the United Kingdom and the United States on the problem of international tax avoidance, the Group of Twenty decided to commission the OECD to study the issue. A much more public spotlight could create an intriguing policy-making dynamic. In short, the international tax policy-making process initiated with the OECD's BEPS report and action plan may unfold transparently in the arena of public opinion, rather than within the confines of the usual small community of policy makers, private sector actors, and tax practitioners. This dynamic could ensure that the general thrust of the BEPS project is not derailed, but instead results in national legislative outcomes that are intended to shore up source-country corporate income tax bases. If this does occur, the project could be the impetus for what might be a sustainable sea change in policy direction, with a consequent rejection (or at least softening) of the perceived imperative to enhance the attractiveness of national tax systems for cross-border investment. The latter has unquestionably been the dominant policy mantra in the area of international taxation for at least the last 20 years.

The three articles that follow—from, respectively, an Australian legal academic, an American academic economist, and a Canadian tax practitioner—consider various aspects of the BEPS project. Each of these invited contributors has spent a considerable portion of his career working in the area of international taxation.

In the first article, Richard Vann observes that both the BEPS report and the subsequent action plan provide little discussion of the relevant tax policy issues. He argues that this is at least curious, given that the BEPS project represents a policy contradiction relative to much of the corporate tax policy work undertaken by the OECD over the past two decades. Most of that work has highlighted the inefficiencies of the corporate income tax as articulated in the economic literature. The policy lesson taken up by the OECD has been the need to reduce reliance on corporate income taxes in national tax mixes, in favour of more efficient taxes such as the value-added tax. Vann emphasizes, however, that the economic literature is motivated by the development of simplistic models that should not be the basis of such categorical policy prescriptions. He welcomes the BEPS project as an opportunity to revive the corporate income tax as a well-designed policy instrument that can measure returns to capital in their various forms and locate them appropriately in the jurisdictions where value is added and should be taxed.

James Hines Jr., on the other hand, wonders in the second article, not whether BEPS is too large, but why it seems to be so small. His approach to the question is largely empirical, and based on the magnitudes of the impact of corporate taxation on multinational firm decisions. In terms of both firm financing decisions and within-firm pricing decisions that influence the location of profits, Hines finds that corporate tax differentials do affect corporate decisions, but that the magnitudes are not sizable. He also notes that the current system effectively allows for lower tax burdens for internationally active firms than for domestically focused firms. If BEPS reforms were successful, there might be pressure to lower corporate income tax rates to compete for internationally active firms. This would also change the tax payable by domestically focused firms and could lead to lower overall tax collections from the corporate sector.

In the third article, Scott Wilkie suggests that the general thrust of the BEPS initiative can be seen in prior unrelated work of the OECD and that, in some important respects, the project simply consolidates much of that work. Nonetheless, he suggests, the new political dynamic has provided a fresh policy imperative. In terms of the substantive focus of the BEPS project, Wilkie argues that the various points of study ultimately share the common feature of a reconsideration of the sourcing of income for tax purposes. At a more refined level of detail, he argues that there must be a movement away from the location of risk management as a dominant variable determining the sourcing issue to a focus on other variables, such as the location of sales, the involvement of employees, and the deployment of assets—all of which are more commonly associated with systems of formulary apportionment as an approach to the sourcing question.

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