

JULY 2015

Change lives. **For good.**

act:onaid

LEVELLING UP:

Ensuring a fairer share of corporate tax for developing countries



GLOSSARY

Base erosion and profit shifting:	Tax avoidance practices that legally reduce the base of activity on which a company is taxed (“base erosion”) or shift a company’s profits into a lower-tax jurisdiction.
The BEPS Project:	An effort to tackle base erosion and profit shifting, led by the Organisation for Economic Cooperation and Development (OECD) and mandated by the G20 countries.
Bilateral taxation treaty:	A treaty that divides taxing rights over cross-border income between a source and a residence country.
Controlled foreign company rules:	Anti tax-avoidance rules that allow a residence country to tax a company’s profits in tax havens at the residence country’s own tax rate.
Permanent establishment:	A company’s taxable presence in a country, created by commercial activities of a certain type or duration.
Residence country:	A country where a multinational is resident for tax purposes.
Source country:	A country where a multinational invests.
Tax competition:	The practice of countries undercutting each other by offering tax breaks or lower tax rates to attract investors.
Tax evasion:	Criminal tax fraud (as distinct from tax avoidance, which is designed to fall within the law).
Tax haven:	A country or jurisdiction that offers low or no taxation, often in combination with secrecy. There is no universally accepted definition of a tax haven.
Transfer pricing:	The pricing of transactions between two companies within the same multinational group. Prices are supposed to be at “arm’s length” – that is, as if two independent firms were trading with each other. Transfer mispricing occurs when prices are inflated or deflated in order to avoid tax.
Treaty shopping:	The routing of investments through third countries to gain tax advantages from their treaties.

CONTENTS

Glossary	2
Executive summary and recommendations	4
Part One: Developing countries and the problem of taxing multinationals	7
Part Two: Why BEPS isn't the answer and what countries can do instead	18
Part Three: Towards a global agreement to curb tax competition	25
.....	
Figure 1: Rich countries collect far more tax from corporations than low-income countries	7
Figure 2: Foreign investment has grown as a share of the economy in low-income countries, but corporate tax revenues haven't	9
Figure 3: Three small tax havens account for a quarter of all foreign direct investment	10
Figure 4: The OECD model treaty depresses source countries' taxing rights	13
Figure 5: The high cost of tax incentives	15
Figure 6: How the BEPS recommendations fall short	19

EXECUTIVE SUMMARY

The status quo in international corporate taxation is broken and archaic and current attempts to fix it are tinkering around the edges. We need a new approach: countries acting for themselves to boost their own corporate tax revenues, and in the long term a new global agreement to curb tax competition and tackle tax avoidance. This will benefit all countries, but especially developing countries, which currently lose out the most.

Corporate tax avoidance scandals around the world have underlined the extent to which some multinational companies have been able to slash their tax contributions, sometimes close to zero. Developing countries, where most of the world's poorest people live, are particularly vulnerable to corporate tax dodging; yet they badly need tax revenues to provide public services and are more dependent on corporate taxes than developed countries.

International corporate taxation is governed by a multitude of rules and treaties between countries, some of whose underlying principles date back nearly a hundred years. Some multinationals have become skilled at legally exploiting them – often in conjunction with tax breaks offered by governments – so as to pay less tax. Tax rules are also commonly shaped by lobbying from big business. In addition, the network of tax treaties tends to favour the residence countries of multinationals over the source countries where they invest, which include most developing countries.

The result of all these problems is that developing countries collect much less corporate tax than they otherwise could – revenue that could help to pay for public services and the fight against poverty. Foreign direct investment stock in low-income countries has more than doubled since the 1990s as a share of GDP but corporate tax revenues have not kept up. The United Nations Conference on Trade and Development (UNCTAD) has estimated that the amount of tax avoided in developing countries may be equal to nearly half of the amount of corporate income tax revenue collected.¹

Against a backdrop of public anger, governments have recognised that the status quo is deeply flawed, but the official response, as embodied in the Base

Erosion and Profit Shifting (BEPS) Project run by the Organisation for Economic Cooperation and Development (OECD), falls far short of what is needed.

It is even possible that current efforts to crack down on tax dodging could have some success, yet could still fail to ensure that effective tax rates paid by multinationals are higher in the long run than they are at present, because of new tax cuts and tax breaks granted by governments around the world. Tax competition is a global problem: the proliferation of tax holidays and other incentives across developing countries has its counterpart in the spread of tax breaks, notably for intellectual property, in many higher-income OECD countries. The OECD cannot meaningfully address this problem, however, given that the tax-cutting practices of some of its member countries are a major cause of it.

Key messages of this report

- > **International corporate taxation is broken and archaic and it harms all countries, especially developing countries.**
- > **The Base Erosion and Profit Shifting (BEPS) Project will not solve tax-dodging and is not addressing the deeper problems associated with tax rules and treaties which harm poorer countries.**
- > **Developing countries can't wait for global agreement. Some have taken action to protect their corporate tax revenues. Others could do the same.**
- > **In the long term, a new global deal is needed to curb tax competition between countries and tackle tax avoidance.**

Why the BEPS Project can't solve developing countries' tax problems

The BEPS Project has a mandate from the world's most powerful governments, the member countries of the OECD and the G20. It sets out to address the problem that multinationals have often been able to shift taxable income out of the countries where it is earned and into tax havens, where it is taxed lightly – if at all. But its recommendations cannot be expected to address the major problems of developing countries in taxing multinationals because:

- The BEPS Project embodies the assumptions of the rich countries that dominate the OECD and it has only engaged with developing countries outside the G20 in a limited or belated fashion. It will not address the need for a fairer division of taxing rights between residence countries and source countries (which includes most developing countries).
- The OECD assumes that no or low corporate tax is only a bad thing when corporations can artificially shift their taxable profits out of the countries where their substantial economic activities take place. This approach ignores the fact that less corporate taxation would mean less revenue for developing countries, and it does not address the problem that costly tax competition between countries is not based only on artificial schemes but also on trying to attract substantial investment.
- Many of the BEPS proposals are quite weak or difficult to apply. For instance, the OECD is still wedded to the 'arm's-length principle' for pricing the third of world trade that is estimated to take place within multinationals. However, this approach is highly technical, open to abuse and heavily demanding on the resources of national tax authorities in poorer countries.

The take-up of the BEPS recommendations around the world will be influenced by the reality that some governments, while often prepared to protect their own revenues against tax dodging, are more than willing to undercut other countries' tax revenues (and their own) by offering tax cuts and tax breaks. It is likely that such governments will take a 'pick and mix' approach to the BEPS recommendations, meaning that some loopholes may be closed while others are left open.

Too many governments are still trying to attract foreign investment by undercutting other countries on tax. This strategy is ultimately self-defeating because if it succeeds, other countries can simply copy it. As the International Monetary Fund's Managing Director

Christine Lagarde has put it: "The problem with the race to the bottom is that everybody ends up on the bottom." Research from the IMF has found that the spillover effects of cutting taxes mean that all countries lose out on tax revenues, with developing countries standing to lose more than twice as much as richer countries.²

What can developing countries do?

The problems of international corporate taxation mean that developing countries collect much less revenue than they could. It could take years, however, to tackle the assumptions and vested interests that underlie the status quo. In the meantime, countries – especially the poorest – need more revenue to build hospitals, schools and roads. They cannot and should not wait for the world to catch up.

Some developing countries have already adopted measures that can help to protect their corporate tax bases and others could follow their example. These measures include increasing withholding taxes on financial outflows; curbing excessive tax deductions by corporations (a common component of tax avoidance schemes); and adopting simpler methods of transfer pricing which are easier to police. Such actions may require developing countries to renegotiate their bilateral tax treaties with other countries or, as a last resort, to cancel them.

Many developing countries have offered large tax incentives to investors in the hope of attracting more foreign investment. There is a very strong case for governments to rigorously review tax incentives and remove those that cannot be shown to produce benefits to the economy and society that are greater than their costs in foregone revenue. Groups of countries, such as regional economic communities, can also forswear tax competition against each other.

The governments of developed countries, if they are serious about their public commitments to combat poverty and promote sustainable development, can also take steps. They can support a bigger role in international tax coordination for the United Nations, which is a more inclusive body than the OECD. They can review their own tax rules and treaties and revise them where they are harming poorer countries. They can adopt stronger anti-tax haven rules to deter their multinationals from shifting profits out of developing countries. And they can require multinationals to publish key tax and financial data on a country-by-country basis: this would not only help national tax authorities in other countries but, crucially, enable greater public scrutiny of corporate taxation.

In the long run, there will need to be a global settlement that ensures greater fairness between richer and poorer countries and brings an end to countries trying to undercut each other's tax revenues. Such a settlement would be more effective if enacted via a global agreement, which would most likely need to put a floor under corporate tax rates and set a common definition of the corporate tax base (the income that can be taxed). This could also be the point at which to abandon the 'arm's length principle', which treats multinationals as if they were collections of independent entities, and move to the taxation of multinationals as single global entities.

It may take years and a great deal of diplomatic effort to reach such a global settlement. But it will be necessary to relieve the pressure of tax competition on developing countries, enabling them to raise more revenue than they otherwise would, and placing them in a stronger position to invest in curbing poverty.

International corporate taxation, in its current form, has developed piecemeal since the era when the world was dominated by Western colonial powers. The world has changed out of all recognition in that time; developing countries expect, and are entitled to, a much fairer deal in the global economy. Now is the time for a bold new approach to taxing multinationals.

RECOMMENDATIONS

The governments of developing countries could:

- Review tax incentives for investors and scrap those whose costs in foregone revenue are not clearly shown to be outweighed by their benefits to the economy and society.
- Adopt unilateral measures to protect their tax bases, such as disallowing excessive tax deductions by corporations and requiring them to use simpler methods of transfer pricing.
- Review and renegotiate their bilateral tax treaties to enhance their source taxing rights and be very wary of signing new ones. As a last resort, harmful treaties could be cancelled.
- Continue to press for an intergovernmental body for tax cooperation at the United Nations, with sufficient resources and a broad mandate that extends to source and residence taxing rights and tax competition.

The governments of developed countries should:

- Support the creation of an international body for tax cooperation at the United Nations, with a broad mandate and sufficient resources.
- Review their own tax rules and treaties and revise them where they are harming poorer countries.
- Ensure their anti-tax haven (Controlled Foreign Company) rules are effective and apply to profits shifted by multinationals out of third countries, not just the developed country itself.
- Require multinationals to publish country-by-country reports on their turnover, profits, taxes and key economic data such as numbers of employees and tangible assets.

All governments should:

- Stop trying to undercut each other's tax revenues by lowering effective tax rates for multinationals, through whatever means.
- Work in the longer term towards a global agreement to curb corporate tax competition, which would probably require a minimum effective tax rate and common tax base, and consider a shift to unitary taxation.

PART ONE: Developing countries and the problem of taxing multinationals

Taxes, teachers, nurses and roads

Governments need taxation to raise funds for essential public services for their citizens, such as healthcare and education, and to pay for public infrastructure such as transport which is needed to raise living standards and improve the economy. In developing countries where a majority of citizens live in poverty (or close to it), these tax-funded public services are particularly important. A majority of the world's poor are women and tax-funded public services are vital to their economic empowerment.³

In recent years, developing countries have collected more tax than before. Data from the International Centre for Tax and Development suggest that on average, developing countries collected about 16 per cent of their Gross Domestic Product (GDP) in taxes in 2009 (excluding taxes related to natural resources), compared to about 13 per cent of their GDP in 1990.⁴ ActionAid found a similar average increase in tax collection in five developing countries (Cambodia, Kenya, Nepal, Nigeria and Tanzania) in the decade before 2013.⁵

Even so, levels of tax collection remain much lower than in rich countries. According to the World Bank, tax revenues accounted for 10-14 per cent of GDP in low-income countries in 2009 and just under 20 per cent of GDP in middle-income countries.⁶ This compares to about 33 per cent in OECD countries, rising above 40 per cent in some European countries.⁷ This gap implies that low- and middle-income countries could raise significantly more tax than they

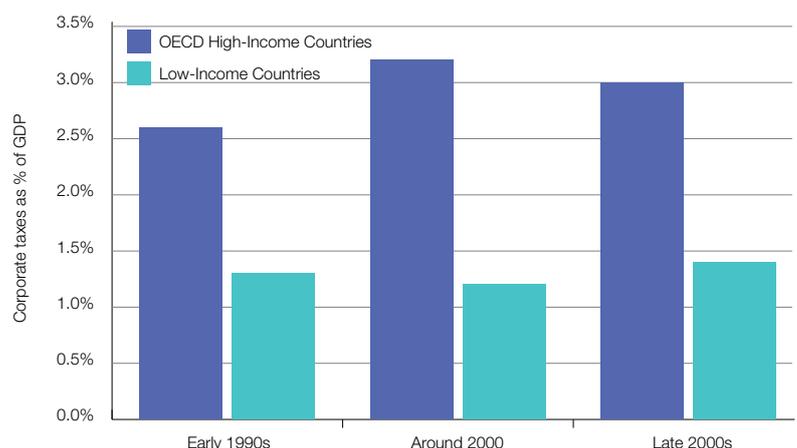
do at the moment. The gap may be even bigger in reality, as some developing countries are known to have underestimated the size of their GDP.⁸

This report looks at a revenue source that is particularly important to developing countries: tax from multinational corporations. If countries are to raise more revenues to pay for their own development, then multinational investments need to be sufficiently taxed. The ability of developing countries to do so faces major challenges, however, because of problems in international taxation which are hard for these countries to influence and because of the practice (common in developing and developed countries alike) of giving away large sums in the form of tax breaks to investors.

Corporate taxation: twice as important for developing countries

Taxing corporations matters more for developing countries. The International Monetary Fund (IMF) has found that corporate income taxes account for about 16 per cent of government revenues in low- and middle-income countries, compared to just over eight per cent in high-income countries.⁹ ActionAid's five-country study found that in 2009-10, corporate taxes accounted for 11 per cent of total revenues in Tanzania, 14 per cent in Cambodia, 16 per cent in Nepal and 20 per cent in Kenya.¹⁰ These estimates do not include other revenues paid by corporations: for developing countries, natural resource royalties and trade taxes can also be very significant.

Figure 1: Rich countries collect far more tax from corporations than poor countries



Source: ActionAid estimates, based on data from the International Centre for Tax and Development (ICTD)

Why tax matters for developing countries: a view from Zambia

Ivor Mwena is the head teacher of Isoko Primary School in Zambia, which is heavily dependent on revenue from mining and has often struggled to raise taxes from multinationals. He told ActionAid:

“Our school was founded in 1942 during British colonial times, and has been housed in its current building since after Zambian independence in the 1960s. As the community has grown, so have the number of children attending the school, and the school building has long been too small to accommodate all the students. The building only has four classrooms, and so the student groups have had to take turns at using the classrooms. This resulted in the school only being able to offer two hours of teaching to each class a day, less than half of what the national curriculum prescribes.

We realised we needed to extend the school and build more classrooms. However, there were no funds to do so, so the community wrote a letter to the government asking for funds, but we did not receive a reply. So with ActionAid’s support the local community sourced building materials and collected some funds to construct a new school building themselves from 2010 onwards.

The new building was ready in October 2014. The extra classrooms means that each student will now get four hours of teaching time instead of two hours a day, bringing the teacher-student time in line with the national curriculum. The school serves over 700



Ivor Mwena, head teacher of a primary school in Zambia

pupils, over half of which can now be taught in the new classrooms.

Although we have the new classrooms, they do not yet have any desks, meaning the students have to sit on the concrete floor during classes. We face other problems as well – while the first seven years of education are free, the students in year 8 and 9 have to pay 100 kwacha (roughly £10) per term. This is a considerable sum of money considering local wages. The grants the school gets from the government are also regularly delayed, meaning it is hard to pay teachers on time. If the government had more tax revenue they could fund constructing more blocks to house more pupils in more schools, pay for the desks in the new building and make sure we receive our grant on time.”

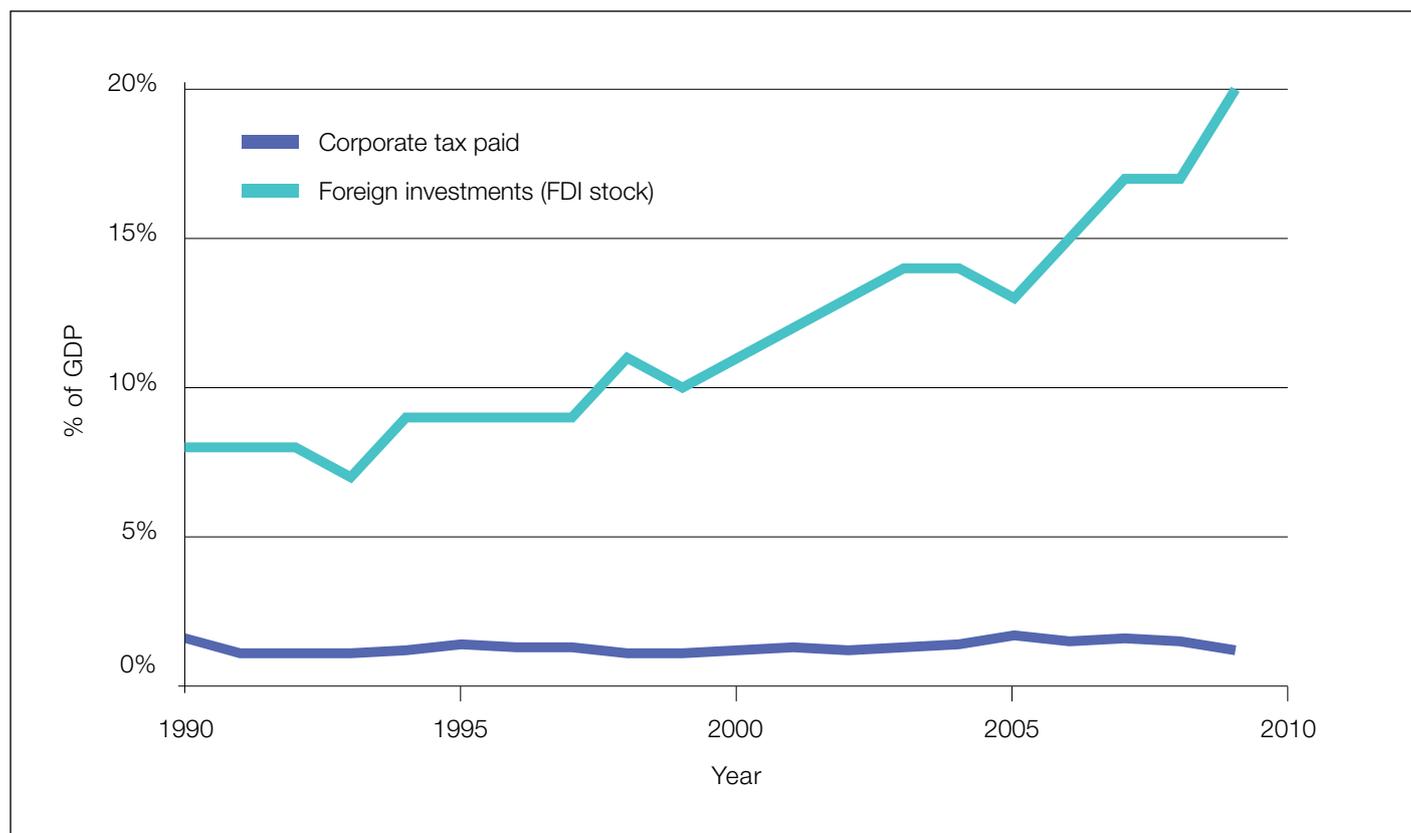
One reason why corporate taxes matter so much is that it is often easier for poorer countries with understaffed revenue authorities to try and collect tax from a few big companies in the formal sector than from individuals, or from the informal economy. That said, ActionAid has found cases where, due to corporate tax breaks and tax avoidance, citizens have actually paid more income tax for a given period than local subsidiaries of multinationals.¹¹

Another reason for the importance of corporate taxes is that developing countries used to earn more from trade taxes but have often cut them back in line with

the free-trade orthodoxy promoted by the IMF, World Bank and aid donors and embedded in trade agreements.

Foreign direct investment (FDI) has grown in importance for developing countries. The IMF says it has tripled since the 1980s to about a third of their GDP.¹² So far, however, the increasing scale of FDI in the world’s poorest countries, as a percentage of their GDP, has not been accompanied by a significant increase in the share of corporate tax revenues in GDP. Costly flaws in international taxation need to be addressed.

Figure 2: Foreign investment has grown as a share of the economy in low-income countries, but corporate tax revenues haven't



Source: ActionAid estimates based on ICTD and UNCTAD data

Tax system? What tax system?

There is no international corporate tax system as such. Each country has its own national tax rules, which can affect other countries by influencing the behaviour of investors. Then there are bilateral tax treaties that divide up the rights to tax corporate income between 'residence' countries where multinationals are headquartered and 'source countries', where they invest. And there are rules or agreements that aim to standardise certain tax rules across regions: examples include the legal directives of the European Union or the tax cooperation agreement of the Southern African Development Community.¹³

There are also global norms and guidelines from the Organisation for Economic Cooperation and Development (OECD) and the UN Committee of Experts on International Cooperation in Tax Matters. The OECD, which is dominated by countries from the global North, is vastly better-resourced and more influential than the UN tax committee, although its dominance has started to be challenged by China, India and other big, middle-income countries (see box, The OECD versus the UN). All this adds up to a

highly complex and sometimes incoherent situation which is far from being a system.

Many multinationals have become skilled at exploiting the complexities of international taxation in order to cut their tax bills. Aided by small armies of lawyers and accountants, they divide up their global activities so that more of their taxable income ends up in tax havens and low-tax jurisdictions. This problem has been made worse by the digitised economy because more and more profit is linked to intangible assets such as software or brands, the rights to which are easily located in tax havens.

Big business is far from being a passive taker of tax rules. Corporate lobbyists constantly argue for lower taxes and tax incentives and warn politicians and the public that without them, job-creating foreign investment will flow elsewhere. Some even take the view that taxes on corporate profits should be abolished altogether.¹⁴ The notion that tax competition between countries is inevitable, even desirable, has come to inform much governmental thinking on corporate taxation.¹⁵

This tax-cutting message has worked its way into the sphere of development. The World Bank, the world's biggest development bank, co-produces an annual 'Paying Taxes' survey with the accounting firm PwC, which includes cuts in business taxes in the category of 'reform', as if they were equivalent to administrative measures designed to make tax quicker and easier to pay.¹⁶ PwC was revealed by the 'Luxleaks' scandal in late 2014 to be the architect of numerous tax avoidance schemes that reportedly channelled at least US\$215 billion in corporate profits through the European tax haven of Luxembourg between 2002 and 2010.¹⁷

The effect of low-tax orthodoxy is that many governments have given up some of their rights to tax corporations by cutting tax rates, granting generous tax breaks and signing bilateral treaties that constrain their freedom to tax. The assumption that companies would not invest without such incentives is debatable at best (see 'The high cost of tax incentives', below).

There is one situation in which tax incentives have been all too effective: when they are enacted by 'conduit' countries that encourage foreign direct investment (FDI) to flow through their jurisdictions on its way to other countries by charging very low rates of tax, or no tax at all. A great deal of FDI now flows through these tax havens and low-tax jurisdictions, which have become integral to the complex internal structures commonly used by multinationals. For example, almost all of the top 100 companies listed

on the London Stock Exchange use tax havens in their global structures, as ActionAid's research has shown. These structures can include hundreds of subsidiaries.¹⁸

Tax havens, conduit jurisdictions and the cost of tax avoidance

The traditional tax havens of public imagination are small territories, often tropical islands. They have tiny domestic economies and offer multinationals a combination of secrecy and very low or no taxation; for this reason, they are also referred to as secrecy jurisdictions. Some tax havens are under the indirect control of OECD countries, such as the United Kingdom's crown dependencies and overseas territories, while others are actually in OECD countries (such as the US state of Delaware).¹⁹

On the same spectrum as the traditional tax havens are the special low-tax regimes that some OECD countries have created to attract the holding companies of multinationals. These regimes are not necessarily secretive and typically exist alongside large domestic economies. UNCTAD's World Investment Report for 2015 has estimated that flows of investment into developing countries via these low-tax regimes doubled in the past decade to about 10 per cent of total FDI.²⁰ The bulk of these flows are accounted for by just two countries – the Netherlands and Luxembourg.²¹

Figure 3: Three small tax havens account for a quarter of all foreign direct investment

Country	FDI stock in per cent of GDP	Share of world FDI (%)	Share of world GDP (%)
Luxembourg	4,710	10.2	0.07
Mauritius	2,504	1.1	0.01
Netherlands	530	15.4	0.91

Source: IMF staff paper. Spillovers in international corporate taxation. May 2014.

The effect of such flaws in international taxation is that, in the words of the OECD: “Some multinationals use strategies that allow them to pay as little as five per cent in corporate taxes when smaller businesses [in OECD countries] are paying up to 30 per cent.”²² The European Commission has noted that: “While the statutory corporate tax rate in the EU Member States lies between 10 and 35 per cent, the analysis of LuxLeaks documents showed that the effective tax rates paid by some multinationals in the EU were below one or two per cent.”²³

If effective tax rates can fall this low in wealthy countries with relatively well-resourced tax authorities, it is not hard to see that the problem might be much worse in poorer countries with fewer tax officials, less expertise and less access to necessary data.

The costs of tax avoidance to developing countries are thought to be very large, even though insufficient data make an exact calculation impossible. UNCTAD’s World Investment Report for 2015 suggested that developing countries may lose “some US\$100 billion” a year in tax due to foreign investment being channelled through offshore hubs.²⁴ An analysis from the IMF in May 2015 offered an even larger figure: a “highly speculative” estimate that developing countries could lose US\$213 billion a year to tax avoidance.²⁵ This represents a huge amount of revenue that could have helped relieve poverty through spending on public services.

The IMF says its own experience in developing countries shows that “the amounts at stake in a single tax planning case now quite routinely run into tens or

hundreds of millions of dollars”.²⁶ This finding is consistent with ActionAid’s own work. Our research on brewing company SABMiller estimated that the company may have avoided as much as US\$20 million a year in tax in Africa and India. Subsidiaries were paying royalties to an affiliate in the Netherlands to use its African beer brands, paying management fees to an affiliate in Switzerland and procuring goods and borrowing money from a related company in Mauritius. All of these countries are tax havens.²⁷

Our 2015 study of Paladin, an Australian-owned mining company active in Malawi, found that over six years the company had paid US\$135 million in management fees to an affiliate in the Netherlands, costing Malawi an estimated US\$20 million in lost tax revenues. The total revenue foregone by Malawi, also due to generous tax breaks granted to the company and tax deductions for interest payments on intra-company loans, was estimated to be US\$43 million over six years, enough to pay the annual salaries of 17,000 nurses.²⁸

Tax avoidance not only deprives governments of a great deal of revenue that could be used to provide public services for the poor; it also gives an unfair advantage to multinationals, in developing and developed countries, over domestic companies which cannot easily reduce their tax bills by shifting income abroad. The problem also undermines trust in the tax system when the public sees big companies avoiding tax while citizens have to pay.



Source: estimates by UNCTAD

The problem of tax evasion

Another huge source of revenue loss is tax evasion. The possible losses from this problem are very large. For example, a recent report by the African Union's High Level Panel on Illicit Financial Flows estimates that the continent is losing some US\$50-60 billion in illicit financial flows each year – money which is going unreported and untaxed.²⁹ The African Union includes tax avoidance in its definition of illicit financial flows.

Global Financial Integrity (GFI), an influential US-based NGO, offers an even higher estimate of illicit financial flows of US\$63 billion in 2012 from sub-Saharan Africa alone.³⁰ This estimate does not include tax-avoiding transactions within multinationals. GFI recommends that trade-related tax fraud be tackled by greater public disclosure of the ownership and tax affairs of companies, and more resources for customs enforcement

The problems of international corporate taxation come to a head in three inter-connected areas that are only partly addressed by the BEPS Project, or not at all (see 'The problem with BEPS', below):

- Bilateral taxation treaties, which divide taxing rights between source and residence countries, and the interaction of these treaties with national tax rules.
- Tax competition caused by governments undercutting each other through offering tax incentives to investors (and, in the case of tax havens, the opportunity to avoid tax completely).
- The pricing of transactions within multinational groups based on the 'arm's length principle'.

A spider's web of tax treaties

The global network of bilateral tax treaties – there are now more than 3,000 of them – was originally intended to encourage investment by dividing up taxing rights between the 'source countries' where multinationals invest and the 'residence countries' where they are headquartered, so that income earned in the former by an investor from the latter would not be taxed in both. These treaties are still commonly referred to as 'double taxation treaties' though it is arguable that double taxation is not as serious a problem as implied, not least because many residence countries no longer commonly tax multinationals' foreign income (see 'Residence countries and tax avoidance', below).

There are two problems with tax treaties for developing countries. Firstly, they tend to skew the global distribution of taxing rights away from countries that are recipients of foreign investment and towards the home countries of multinationals. This is particularly true for treaties based on the OECD model (see box, 'The OECD versus the UN'). Secondly, they facilitate tax avoidance through treaty shopping – the routing of foreign investments via third countries to exploit their tax treaties.

Taxing rights

Tax treaties typically allocate to the source country the right to tax the 'active', or business income, earned by a foreign investor in that country, provided that the investor's activities are of a type and duration which is sufficient to create a taxable presence or 'permanent establishment' (PE). The right to tax 'passive' or investment income is allocated to the residence country.

Multinationals can exploit the provisions of tax treaties, in combination with domestic rules, to avoid tax. One method is to avoid having a permanent establishment in a source country altogether by ensuring, for example, that lucrative sales in that country are booked in a neighbouring tax haven. Giant US digital companies such as Google and Amazon are notorious for this practice in Europe, though Amazon promised to curtail it in May 2015 after heavy public pressure.³¹

A multinational with a permanent establishment in a source country can avoid tax by arranging for a subsidiary in a tax haven to take ownership of assets such as intellectual property or capital. The subsidiary in the source country then makes payments to the offshore subsidiary to use these assets, in the form of royalties, fees or interest on internal loans. Because such payments are deductible from profits in the

source country as costs of business, the effect is to shift profit into the tax haven where it will face little or no tax. Multinationals commonly trade with themselves in this way (see ‘The incomprehensible complexity of transfer pricing’, below).

Developing countries can defend themselves against this kind of profit-shifting by imposing withholding taxes on financial outflows, which means that they can collect at least some tax. But in the hope of attracting investment, developing countries have often signed tax treaties which curtail their rights to charge withholding taxes, or even cancel these rights altogether. This is a significant problem for poorer countries: in some of them, withholding taxes on dividends, interest and royalty payments to foreign entities can account for as much as five per cent of total tax revenues.³²

Treaty shopping

Because some treaties offer better terms for investors than others, such as lower rates of withholding tax, there is an incentive for multinationals to go ‘treaty-shopping’. This means that they route their investments in source countries through the tax havens that have the most favourable treaties with those countries.

ActionAid showed in November 2013 that Deloitte, one of the ‘Big Four’ accounting firms, was advising investors to avoid tax in Africa by routing their investments through holding companies in Mauritius, a tax haven. An investor briefing by Deloitte showed that a Chinese company could exploit Mauritius’ tax treaty with Mozambique to take advantage of treaty provisions on withholding taxes and capital gains taxes. In this way, Deloitte explained, a company could reduce the tax being “suffered” in Mozambique. The latter is one of the world’s poorest countries and had an average life expectancy of 49 at the time that Deloitte was advising investors on ways to dodge its taxes.³³

There are other defence mechanisms against treaty shopping, such as anti-abuse clauses in tax treaties. However, these defences rely on national tax authorities having the means, the information and the determination to successfully challenge tax avoidance schemes that can be highly complex and span multiple jurisdictions.

Residence countries and tax avoidance

Cross-border tax avoidance only makes sense if a multinational can ensure that profits shifted out of a source country end up somewhere where these profits will be taxed less, or not at all. Twenty-six of 34 OECD countries have now adopted some form of ‘territorial taxation’, meaning that income earned by their multinationals abroad is no longer usually taxed at home.³⁴ This gives multinationals a further incentive to shift profits out of source countries.

The US, by contrast to these countries, still taxes the foreign income of its multinationals but only when that income is brought home. As a result, US corporations have accumulated a staggering US\$2.1 trillion in global profits in offshore hubs rather than bring the money back to the United States. These offshore funds are actually allowed to be invested in the US in various ways – they just aren’t taxed there.³⁵ As with a territorial system, this ‘worldwide system with deferral’ gives a big incentive to US corporations to avoid taxes in other countries if they can.

Residence countries do have rules that are meant to deter their multinationals from shifting income into tax havens. These ‘controlled foreign company’ (CFC) rules aim to nullify the incentive for multinationals to shift profits into tax havens by stipulating that tax must still be paid on these shifted profits at the residence country’s tax rate. CFC rules are designed to protect residence countries but they can also deter profit-shifting from other countries, as long as they apply to

Figure 4: The OECD model treaty depresses developing countries’ taxing rights

Model Treaty	Maximum WHT on dividends	Maximum WHT on interest	Maximum WHT on royalties
OECD	5 or 15 per cent*	10 per cent	Exempt from WHT
UN	No maximum limit	No maximum limit	No maximum limit
SADC	No maximum limit	No maximum limit	No maximum limit
ASEAN	15 per cent	15 per cent	15 per cent

* The lower rate of WHT would be charged on dividends when the foreign company owns more than 25 per cent of the subsidiary in the source country.

Source: OECD, UN, SADC

Taxing rights: the OECD versus the UN

The OECD was established in 1948 to run the US-financed reconstruction of Europe after the Second World War. The great majority of the OECD's 34 members are in the global North. The OECD has a huge influence on international tax norms and practices, and its members have been adamantly opposed to expanding the role of the United Nations in tax matters, which would give a greater say to developing countries. The UN's Committee of Experts on International Cooperation in Tax Matters has members from OECD and non-OECD countries. It has an explicit mandate to consider relationships between developed and developing countries, but has a fraction of the OECD's resources, employing only two full-time staff and meeting in plenary just once a year.

The OECD is a champion of the 'arm's length principle' used for transfer pricing within multinational groups. This highly technical approach, which rests on the fiction that multinationals can be treated as collections of separate entities, is particularly difficult for tax officials in poor countries to apply.

The OECD's Model Tax Convention (a blueprint for tax treaties) limits the rates of withholding taxes that source countries can charge on financial outflows to between zero and 15 per cent (see Figure 4). This limitation matters because withholding taxes are an important counter-measure against profit-shifting. In at least 40 developing countries, withholding tax rates for at least one form of passive income (that is, income from investments) are set in domestic law at higher than 15 per cent, sometimes much higher.³⁶ So if developing countries bind themselves to treaties based on the OECD model, and these treaties override their domestic law, then they may be giving away taxing rights on significant amounts of revenue.

The UN Model Double Taxation Convention is more favourable for developing countries in the sense that it gives them more room to negotiate withholding tax rates with their treaty partners, as well as offering a slightly wider definition of

what can be taxed. For instance, the UN Model gives greater scope to source countries to tax the provision of services.³⁷

Large developing countries have questioned the OECD's dominance on tax matters and called for a bigger role for the UN. A strongly worded letter from India in 2012 complained: "It is inconceivable as to how a standard developed by governments of only 34 countries can be accepted by governments of other countries as a 'standard' of sharing of revenue on international transactions between source and resident country when it only takes care of the interest of developed countries and has seriously restricted the taxing power of source countr[ies]."³⁸

At the time of writing (mid-2015), the issue of upgrading the UN expert committee into an inter-governmental body, or replacing it with new body, was under negotiation between governments in the UN's Financing for Development framework. The G77 group of developing countries and China were calling for a stronger role for the UN while OECD countries were generally against it (though there were reports of divergent views among European countries).³⁹

A stronger UN tax body could not be expected to rapidly solve all the problems of international corporate taxation, some of which are deep and intractable. But given the right mandate and resources, it could respond to these problems in a more inclusive way than the OECD because all the world's countries have a seat at the UN and a say in its deliberations.

Regardless of the outcome of current negotiations over the role of the UN, the landscape of international tax cooperation is slowly shifting. A sign of changing times is that the Base Erosion and Profit Shifting (BEPS) Project, though led by the OECD, has been carried out under the auspices of the G20 group of countries, which includes China, India and other big developing countries. It seems probable that these larger countries, if not all developing countries, will exert a greater influence over the norms and practices of international taxation in future.

all of a multinational's income in tax havens, regardless of where that income has come from.

As the OECD has noted, CFC rules that also cover profits shifted out of third countries would help to protect developing countries.⁴⁰ Not all CFC rules do this, however. The UK's rules used to do this, but were deliberately watered down in 2012 so as to only apply to income shifted out of the UK itself. Although the government has stopped short of explicitly saying so, the obvious result of this change has been to make the UK more attractive as a base for multinationals by removing a deterrent to their avoidance of tax in other countries.

One provision of the UK's CFC rules, the so-called 'finance company partial exemption', actually offers a 75 per cent tax break on profits a multinational makes from lending to itself via an offshore hub. One prominent British tax adviser described this provision as "almost government-approved tax avoidance".⁴¹

The high cost of tax incentives

Many governments set out to attract investment by offering tax incentives that are often exceedingly expensive, even though their effectiveness is doubtful. The problem of tax incentives can be seen as an aspect of the wider problem of tax competition between countries, which can also take the form of

lowering headline tax rates for all companies (see Part Three: Towards a global agreement to curb tax competition).

Tax incentives for investors impose a very large cost on national treasuries in addition to the costs of tax avoidance and evasion. ActionAid estimated in 2013 that developing countries, mostly upper-middle income countries, give away some US\$139 billion a year in corporate income tax incentives.⁴² Tax incentives have proliferated across sub-Saharan Africa, according to the IMF, with 69 per cent of countries offering tax holidays compared to only 45 per cent in 1980, and more than half of countries reducing their headline rates of corporate income tax.⁴³

Governments in East Africa were giving away up to US\$2.8 billion a year in tax incentives, according to research published in 2012 by ActionAid and the Tax Justice Network-Africa. Not all of these incentives are bad. Some, such as reductions in value-added taxes, can help reduce poverty. But much of the cost was explained by tax breaks which are meant to attract foreign investment but are not necessary to do so.⁴⁴ The problem of generous tax incentives is a global one and not confined to developing countries by any means. The UK has been chastised by its legislators for failing to keep tabs on tax breaks worth billions of pounds a year, including some for large companies.⁴⁵

Figure 5: The high cost of tax incentives

	Annual corporate income tax foregone (US\$ billion)
Developing countries by region	
Europe and Central Asia	24.5
Middle East and North Africa	4.7
East Asia and Pacific	55.1
South Asia	13.8
Sub-Saharan Africa	7.6
Latin America and the Caribbean	33.2
Developing countries by income group	
Low	2.5
Lower-middle	29.2
Upper-middle	104.5
Total	138.9

Tax incentives take various forms. Discretionary incentives give favourable treatment to particular companies; they are often awarded behind closed doors and are particularly vulnerable to corruption and influence-peddling. Tax holidays apply to a period at the start of an investment while free zones offer tax breaks to companies that locate within them. Stability agreements between investors and governments freeze the tax terms applied to the former, making it harder for governments to change them in future.⁴⁶ In rich countries, there has been a recent proliferation of tax breaks on the profits from intellectual property – the so-called ‘patent boxes’ and ‘knowledge boxes’.

International institutions that previously encouraged tax incentives in developing countries have swung away from them. In 2011, a report to the G20 by the IMF, OECD, United Nations and World Bank concluded that: “Incentives, including corporate income tax (CIT) exemptions in free trade zones, continue to undermine revenue from the CIT; where governance is poor, they may do little to attract investment – and when they do attract [FDI], this may well be at the expense of domestic investment or FDI into some other country. Tax-driven investment may also prove transitory.”⁴⁷

The ostensible justification for tax incentives is that governments must attract investment to create jobs and other benefits to their economies, even if this means giving up some revenue. Smaller and poorer developing countries with less to offer foreign investors in other ways may feel that they have no choice but to offer tax incentives. However, the evidence suggests that tax is only one factor in investment decisions and not the most important. The IMF argues: “Reduced tax rates and incentives can attract foreign investment, but only where other business conditions are good. Business surveys repeatedly find that while taxation matters for foreign investors, other considerations – infrastructure, rule of law, labor – matter more.”⁴⁸

If one country succeeds in attracting more investment by slashing its effective tax rates, then other countries will inevitably do the same. A research paper from the IMF has estimated that if all countries cut their headline tax rates by one per cent, then a typical country’s tax base is cut by 3.7 per cent. The paper notes: “The spillover base effect is largest for developing countries. Compared to OECD countries, the base spillovers from others’ tax rates are two to three times larger, and statistically more significant.”⁴⁹

The logical end-result of countries continuing to undercut each other by lowering tax rates and offering

tax breaks must be that the most mobile forms of international capital are eventually not taxed at all. As the IMF’s Managing Director Christine Lagarde succinctly put it in a speech in 2014: “The trouble with the race to the bottom is that everybody ends up on the bottom.”⁵⁰

The incomprehensible complexity of transfer pricing

Another core concept of international taxation to come under strain is the “arm’s length” principle’. Long championed by the OECD and adopted into national tax regimes around the world, the “arm’s length” approach requires transactions within multinational groups to be priced by comparison with similar deals between independent companies in an open market.

Intra-group trade is thought to account for more than 30 per cent of all world trade.⁵¹ Multinationals have a big incentive to misprice these transactions so that as much profit as possible is allocated to their subsidiaries in tax havens. The sums involved are very large: UK tax officials, for example, have reclaimed around US\$1.3 billion a year by challenging the transfer pricing assessments of multinationals.⁵²

The process of determining the “arm’s length” price is highly technical and agreement on the correct price can come down to negotiation between the multinational and the tax authority. The former, with its expert advisers and superior access to market data, is often in a much stronger position than the latter. Datasets of comparable transactions (or “comparables”) may be expensive for tax authorities to obtain or difficult to use. The Kenyan Revenue Authority bought an expensive comparables database and was largely unable to find relevant data in it.⁵³ Rwanda’s tax authority has previously declined to buy such databases, citing similar concerns.⁵⁴

The “arm’s length” principle is flawed because it is based on a fiction: in reality, the management of a multinational group has a high degree of control over the form and timing of transactions within the group, which could never exist in a deal between independent companies in the open market. The Independent Commission for the Reform of International Corporate Taxation (ICRICT), an ActionAid-supported group of former ministers and top economists including the Nobel Prize-winning economist winner Joseph Stiglitz and former UN Under-Secretary-General José Antonio Ocampo, concluded in June 2015 that: “Multinational corporations act – and therefore should likewise be

taxed – as single firms doing business across international borders.”⁵⁵

Large developing countries have come up with their own variations on transfer pricing out of dissatisfaction with the OECD’s approach. China and India have championed the concept of ‘location-specific advantages’: they consider that access to the huge Chinese and Indian markets is in itself a source of value for multinationals, so a greater share of profits from intra-group transactions should be allocated to subsidiaries in China or India (and taxed there).⁵⁶

Brazil has adopted its own approach based on a requirement for multinationals to use fixed margins for pricing transactions with related companies, or with companies in low-tax jurisdictions, thus making it harder to allocate large amounts of profit to tax havens.⁵⁷ India and some Latin American countries use the ‘Sixth Method’, in contrast to the five main methods favoured by the OECD, which links the pricing of commodity transactions between subsidiaries to the price of that commodity in the open market (meaning that it is not necessary to hunt for comparable transactions).⁵⁸

The OECD is a staunch defender of the arm’s length principle, complaining that: “Civil society and NGOs [are] sometimes addressing very complex tax issues in a simplistic manner and pointing fingers at the “arm’s length” principle ... as the cause of all these problems.”⁵⁹ In practice, the OECD seems to be quietly shifting towards an emphasis on ‘profit-split’ methods, which rely less than others on the need to find comparable transactions in the open market.

There is a credible longer-term argument for ditching the arm’s length principle altogether and moving to unitary taxation, as ICRICT recommends. Under this system, a multinational would file a single set of accounts on its global income and the rights to tax

this income would be divided among the countries where it operates on the basis of a pre-agreed formula. This approach would remove the incentive for profit-shifting into tax havens, since the profits would be taxed irrespective of where they ended up. ICRICT also recommends a minimum global tax rate, which would be needed to stop countries undercutting each other by offering tax breaks on their shares of the profit allocated to them. At the time this briefing was written in mid-2015, the European Commission was attempting to revive a plan for a ‘common consolidated corporate tax base’, a form of formulary apportionment (see ‘A “ceasefire agreement” and common regional tax rules’, below).

The implications of unitary taxation for developing countries are unclear and would not necessarily be positive for some countries, depending on what formula is used. For example, states in the United States use a formula based on sales. But many developing countries are suppliers of raw materials and labour, not big sales markets for multinationals, and might lose out from a sales-based formula, compelling them to find other ways to raise revenues from companies.⁶⁰ For this reason, a careful assessment of the potential winners and losers from unitary taxation would need to be part of any transition.

A move towards unitary taxation would need to go hand-in-hand with the democratisation of tax policy-making, for example by enhancing the role of the UN over the OECD. Otherwise, there is a risk that the design of the formula would be dominated by bigger and richer countries in their own interests. An intermediate step could be for national tax authorities to make greater use of formulary methods to determine what tax should be paid by multinationals in their jurisdiction.

PART TWO: Why BEPS isn't the answer and what countries can do instead

The BEPS Project: exclusive, incomplete and insufficient

There is now widespread awareness that international corporate taxation needs reform to make it fairer and to curb abuses by multinationals. The biggest fruit of pressure for reform since the 2007 financial crisis has been the OECD's Base Erosion and Profit-Shifting (BEPS) Project. This project was endorsed by leaders of the G20 countries in September 2013, giving a mandate to the OECD to come up with proposals for curbing corporate tax avoidance.⁶¹

The OECD's Centre for Tax Policy and Administration is set to publish 15 detailed sets of recommendations between September 2014 and December 2015, covering topics from transfer pricing, to the complex tax avoidance structures known as hybrids, to the design of anti-tax haven rules and the availability of data to tax authorities. These recommendations are meant to be implemented in three ways: by a new multilateral agreement, by the updating of the OECD's own guidelines (which have quasi-legal status in some countries) and by changes to national tax laws.

The BEPS Project has created an expectation of reform and some concrete reforms may arise from it. But as a response to deep-seated problems in international taxation, the project is deeply flawed and cannot address some of the biggest concerns of developing countries.

The BEPS Project is attempting to shape global norms although governments that are not members of the OECD or G20 – that is, most of the world's governments – have not been meaningfully included. Some were invited to 'dialogue meetings' and consultations but it was not until November 2014, after loud criticism (including from civil society organisations like ActionAid) that a small number of developing countries were invited to join key meetings.⁶² This was still only a small proportion of countries and by the time they joined, the parameters of the BEPS project had already been set.

The capacity of the private sector to influence BEPS discussions is vastly greater. For example, 87 per cent of responses to the BEPS consultation on country-by-country reporting – an important form of transparency

originally devised by civil society campaigners of the Tax Justice Network – were from business. The overwhelming majority were against this form of reporting. Corporations are fully entitled to argue their views, but the sheer ratio of business submissions versus non-business submissions across the BEPS process is a telling indicator of the power dynamics at play.⁶³

From the start, BEPS has been limited by assumptions that reflect the interests of wealthy countries in the global North. One assumption is that tax avoidance can be addressed separately from imbalances between the taxing rights of residence and source countries. The OECD acknowledges that the latter is a big concern for developing countries, which are mostly source countries, but does not see the BEPS Project as the place to address it.

Another highly problematic assumption, often repeated by the OECD, is that, "low or no [corporate taxation] is not a cause for concern per se, but it becomes so when it is associated with practices that artificially segregate taxable income from activities that generate it."⁶⁴ Yet if corporations pay less tax then either someone else must pay more, or public services must be cut. For poor countries the claim is actually harmful: if these countries were no longer able to tax corporations, they would lose a great deal of revenue that they would struggle to make up from other sources, if at all.

At the time of writing, it seems likely that many countries would adopt a 'pick and mix' approach to the BEPS recommendations, choosing which ones to adopt and in what form. Such an approach might lead to more corporate tax being paid, though it is not clear which countries might benefit. It is likely that there will be many gaps and loopholes in the implementation of the BEPS Project as governments, urged on by corporate lobbyists, pursue what they see as their own national interests.

Many of the BEPS Project recommendations are too weak, too complicated or are actually harmful as far as developing countries are concerned.

Figure 6: How the BEPS recommendations fall short

Problem	What BEPS proposes	Implications for developing countries	What countries could do instead
Multinationals avoid a taxable presence or 'permanent establishment' in a source country.	Minor changes to the definition of 'permanent establishment' in tax treaties.	Inadequate in response to the digitalised economy and the ability of companies to do business from offshore.	Developing countries could strengthen source taxing rights on service fees and consider counter-measures such as anti-abuse rules.
Multinationals can claim big tax deductions in source countries for inter-company payments to tax havens.	Where it is not certain that a residence country will tax income, the source country can tax it. Limiting deductions for debt interest.	BEPS underlines the need for a general principle that income not taxed in one jurisdiction must be taxed in another. The proposals on debt interest allow a wide range of exceptions, however.	Developing countries could limit or disallow more tax deductions. They can also impose higher withholding taxes on inter-company payments. This may require renegotiating or exiting from tax treaties.
Multinationals can route their investments via tax havens to take advantage of their tax treaties with source countries.	Inserting anti-abuse clauses into all bilateral tax treaties.	Anti-abuse clauses might help, but this proposal doesn't address the bias of taxing rights towards residence countries in the OECD Model treaty.	Developing countries could renegotiate their treaties, not just to strengthen anti-abuse clauses but to increase their source taxing rights.
Some countries offer tax breaks which are designed to undercut other countries' tax bases.	Placing limits on certain kinds of tax breaks linked to intellectual property.	The proposals do not address the tax breaks most common in developing countries and do little to curb tax competition.	Rigorously review all tax breaks for investors and scrap those whose benefits to society do not justify their costs.
The "arm's length" method for pricing transactions within multinationals is highly complicated and open to abuse.	Complex, minor changes to the status quo.	The proposals will not address the problem of transfer mispricing in developing countries.	Rely on simpler methods, such as profit splits, and consider alternatives like fixed margins or the 'Sixth Method'.
Some developed countries have weak anti-tax haven (CFC) rules.	Minor revisions to CFC rules.	The BEPS proposals are very weak because they do not require CFC rules to deter profit-shifting out of third countries, including developing countries.	Developed countries should strengthen their CFC rules and make sure that they apply to corporate profits shifted out of third countries.
Lack of transparency makes it impossible for tax authorities and the public to hold multinationals to account.	Large multinationals should make country-by-country reports of key tax and financial data to national tax authorities.	Only covers very big companies. Reports wouldn't be public and may not be easily available to developing countries.	Developed countries should require their multinationals to make these reports public. The reporting threshold must be low enough to capture all large companies.
	Extend and formalise the use of arbitration to resolve disputes related to tax treaties.	Likely to constrain governments' freedom of action in dealing with investors.	Reject the proposal and improve the resolution of tax disputes through the domestic legal system.
The OECD wants all countries to adopt the BEPS proposals.	A multilateral agreement that incorporates many of the BEPS proposals.	Likely to reinforce the OECD's bias towards residence countries.	Developing countries should not sign such an agreement.

If BEPS won't solve the problem, what can developing countries do?

BEPS is not going to be the holistic overhaul of international corporate taxation that developing countries need. In the longer term, there will need to be a new consensus that recognises the imperative not only to curb tax avoidance but also to stem tax competition and redistribute the power to set taxing norms more fairly between richer and poorer countries.

Such a consensus does not seem likely to emerge in the near future because the status quo, including the belief in tax competition, is still deeply entrenched. However, some developing countries have already adopted measures to defend their corporate tax bases that could be copied by other countries, whether unilaterally or in regional groupings. Over time, such measures should put pressure on OECD countries, and on multinationals themselves, to recognise the need for a fairer and more inclusive consensus on international corporate taxation.

So, beyond building up the capacity of their national tax authorities, what measures could developing countries take to shore up their corporate tax bases? The list presented here that follows draws on the work of the Tax Justice Network and other sources.⁶⁵ Not all measures might be appropriate for all countries but they suggest the range of possibilities that exist, even within the constraints of the status quo. Some can be adopted unilaterally, while others may require the revision or scrapping of bilateral tax treaties.

Measures that developing countries could take include scrapping unjustified tax incentives; adopting simpler methods of transfer pricing; taking other measures to deter tax avoidance and increase their source taxing rights; reviewing and renegotiating their tax treaties and ensuring that capital gains, including on indirect transfers of ownership, can be taxed.

Scrapping unjustified tax incentives

Tax incentives are set in domestic law, meaning that a developing country can choose to review them, and scrap or phase out those which do not justify their costs (which are often very large). There may be cases where a government's freedom of action is limited by contracts or investment agreements with foreign companies, in which case these might have to be renegotiated first.

Not all tax incentives are necessarily bad for development and some may be necessary to correct

market failures or achieve aims that cannot be achieved through other policies. But given their huge costs, governments ought to subject them to rigorous scrutiny and cancel or phase out those incentives that cannot be clearly shown to justify this cost.

Some governments are grappling with the problem. For example, Kenya was reported in April 2015 to be considering a proposal from its tax authority to scrap tax exemptions, including a 10-year tax holiday for foreign investors in its export processing zones.⁶⁶ Tanzania passed new laws in 2014 to curb tax incentives, aiming to collect another US\$500 million a year in revenues.⁶⁷ In the Philippines, however, a new law to bring more transparency to tax incentives appeared to be contested in the government, as well as being lobbied against by foreign business.⁶⁸

A first step for governments would be to review all tax incentives granted to investors with a view to removing many of them, especially those that involve the exercise of discretionary power by officials. Incentives should only be retained if it can be shown that their benefits to the economy and society outweigh their costs in foregone revenue. To this end, governments ought to publish an annual analysis that identifies all tax incentives and their beneficiaries, and shows their costs to the national budget.

Where tax incentives are driven by corruption or by patronage – for example, where governments grant tax breaks to companies in return for financial support for the ruling political party – then reform may be hard to separate from wider reforms of governance, such as curbs on political donations and greater transparency in relationships between officials and business people.

Concerns about over-generous tax incentives are far from unique to developing countries. A rigorous review of tax incentives should also take place in developed countries such as the UK where, as noted earlier, the government has been chastised by legislators for failing to keep adequate track of billions of pounds in tax incentives, including for large corporations.⁶⁹

Making transfer pricing stronger and simpler

There is ample scope for multinationals to shift profits out of source countries by having their subsidiaries in these countries trade with affiliates in tax havens at inflated prices. The status quo puts the onus on national tax authorities to determine whether the prices arrived at by multinationals are reasonable or

not. This is a demanding task, even for bigger and richer countries.

A first step would be for a government to ensure that it has specific transfer-pricing rules and a team of specialists in its tax authority that can apply them. The African Union's High Level Panel on Illicit Financial Flows found that: "Very few African countries have transfer pricing units in their government structures, and the few that do have them suffer from staff shortages."⁷⁰

Developing countries could require simpler approaches to transfer pricing, for example based on the Brazilian approach that sets fixed profit margins for transactions within certain parameters. For commodity transactions, the so-called 'Sixth Method' used in India and Latin America, which ties the prices of intra-group transactions to the prices of commodities in the open market, might offer an alternative. Critics argue that this method does not take into account all the factors that might determine the price of a transaction, such as transport costs,⁷¹ but it has the advantage of simplicity.

The BEPS Monitoring Group (BMG), a civil society umbrella group that includes ActionAid, recommends that countries increase their use of profit-split methods, one of the five approaches favoured by the OECD. This approach entails allocating the profits of a transaction to different subsidiaries of a multinational group in line with their contribution to that transaction.

The question of how profits are split is an important one, however. The OECD argues that profits should be split in line with the assets and functions (that is, key people) that each subsidiary contributes to the transaction, and the risks that it assumes. The BMG disagrees, because assets, functions and risks can easily be moved around within a multinational group so as to allow the attribution of more profits, based on these factors, to subsidiaries in tax havens. The BMG argues instead for the adoption of simple 'allocation keys' for factors which are harder to shift around, such as numbers of staff, expenses, revenues and numbers of customers.⁷²

While such approaches offer a simpler and more effective way for developing countries to respond to transfer mispricing, they do not address the essential problem of the arm's length principle: that it treats centrally controlled and highly coordinated entities as if they could be compared to independent companies working separately of each other. This is why reforms of the current system cannot substitute for the possibility of a global shift to unitary taxation in future.

Increasing taxing rights and deterring tax avoidance

Source countries can act against tax avoidance by limiting the amounts that companies can deduct from their profits for payments to affiliates in low-tax countries. Peru, for example, does not allow companies to deduct most expenses derived from transactions with entities in tax havens.⁷³ South Africa has introduced new rules to stop companies deducting more than 40 per cent of their profits to cover interest payments to related companies that are not taxed in South Africa.⁷⁴

Some developing countries, including India and several countries in Latin America, impose much higher withholding taxes on transactions with tax havens as a deterrent to profit-shifting. Brazil applies a 25 per cent tax to transactions with a 'blacklist' of tax havens. Argentina applies a 35 per cent tax on interest payments to tax havens. Chile charges a 30 per cent withholding tax on payments to tax havens for certain types of intellectual property.⁷⁵ These higher deterrent rates in domestic law may, however, be superseded by lower rates in tax treaties.

India and Colombia have both put tax havens on a blacklist – which triggers higher withholding taxes – as a negotiating tactic. Colombia successfully pressured Panama into signing a tax information exchange agreement by putting it on its blacklist.⁷⁶ India suspended its tax treaty with Cyprus as a way of putting pressure on the latter not to allow itself to be used as a conduit jurisdiction for companies from elsewhere to invest in India.⁷⁷

Many developing countries have been pushing for greater taxing rights over services, an area of growing importance in the digital economy. Some African countries, including Tanzania, Ghana and Namibia, are either introducing or increasing withholding taxes on services.⁷⁸ An advantage of the UN model tax treaty is that gives greater authority to source countries than its OECD equivalent by deeming that an entity which carries out service or consulting activities in a source country for more than 183 days in a given year has created a taxable 'permanent establishment' there.

Research by the International Bureau of Fiscal Documentation (IBFD) has found that in 2013, 46 per cent of tax treaties concluded by countries outside the OECD allowed these countries to tax services at source, compared to 31 per cent in 1997.⁷⁹ This suggests that developing countries are having some success in including such provisions in their tax treaties. The UN expert committee is currently working

on a new article on the taxation of payments for services, to be included in the model treaty in future. Debate among committee members at their annual meeting in Switzerland in October 2014 revealed a clear split between OECD and non-OECD countries, with some of the former apparently reluctant to see greater source taxation of services.⁸⁰

If a multinational can do profitable business in a developing country without having a permanent establishment (PE) there, then the country stands to lose tax revenues on those profits. The UK, a source country for many foreign multinationals, has introduced its own unilateral response to the offshoring of corporate profits, including the avoidance of PE status and other artificial arrangements, in the form of a new Diverted Profits Tax.

The effect of this tax is that profits deemed to have been diverted from the UK can be taxed at 25 per cent, rather than the statutory rate of 20 per cent. Australia has come up with its own variant, which involves a modification of its existing anti-abuse rule.⁸¹ The effectiveness of the Diverted Profits Tax has yet to be tested, but the concept could provide a model for developing countries whose authorities are struggling to tax multinationals using existing anti-abuse rules.

Reviewing and renegotiating tax treaties

Any developing country concerned by corporate taxation ought to review its tax treaties with other countries and be very wary of entering into new ones. There are grounds to think that increasing numbers of governments are becoming aware of the loss of revenues arising from unfavourable tax treaties.⁸² These revenues can be very significant. The IMF has estimated that the United States' tax treaties with non-OECD countries cost the latter US\$1.6 billion in 2010 in foregone withholding taxes.⁸³

Studies in the Netherlands have variously estimated the cost of its tax treaties to developing countries, in foregone withholding taxes, at anywhere between US\$150 million and US\$770 million a year.⁸⁴ This is why the IMF notes that, “[developing] countries should not enter treaties lightly – all too often this has been done as a political gesture – but with close and well-advised attention to the risks that may be created”.⁸⁵

The argument against tax treaties is the same as that against tax incentives in general: they are an expensive way to send signals to foreign investors which governments could do in more productive ways – for instance by investing more in improving the country's infrastructure, increasing the efficiency of its

administration or curbing corruption. All of these reduce costs to foreign investors and would have significant and direct benefits for citizens, which tax treaties do not.

Governments ought to review their existing treaties to identify areas where they may be losing revenue, such as overly narrow definitions of a permanent establishment, clauses which pin withholding tax rates below the rates set in domestic law and inadequate anti-abuse measures, particularly in treaties with tax havens. It is also important that treaties do not stop governments from taxing capital gains on the offshore transfer of domestic assets (see below).

Where a treaty is causing significant loss of revenues, or may do in future, governments could request that the treaty be renegotiated. If a treaty partner refuses to renegotiate and the developing country is suffering significant losses, then it may ultimately be necessary for the latter to withdraw from the treaty.

Various developing countries have successfully renegotiated tax treaties with other countries. India is currently doing so with Mauritius, as has South Africa.⁸⁶ Rwanda renegotiated its treaty with Mauritius and agreed a newer treaty which provides for withholding tax rates of 10 percent on dividends, interest and royalties, plus a tax rate of 12 percent on management fees, compared to no taxing rights on these items in the earlier treaty.⁸⁷

Uganda has re-evaluated its position on tax treaties: “We have stopped negotiations of any new agreement until we have a policy in place that will not only offer guidelines but give clear priorities of what our interests and objectives are,” Uganda's commissioner for tax policy, Moses Kaggwa, was quoted as saying in mid-2014.⁸⁸

It is more unusual for a country to withdraw from tax treaties. Indonesia allowed its tax treaty with Mauritius to lapse in 2005. In 2011, Mongolia scrapped its tax treaties with the Netherlands, Luxembourg, Kuwait and the United Arab Emirates. At issue was the Mongolian government's concern that mining companies in the country were avoiding withholding taxes on outbound payments.⁸⁹ Mining companies had committed themselves to large investments in Mongolia at the time of the controversy, which may have offered the government some assurance that scrapping the treaties would not lead to investors pulling out of the country.

For developing countries in a weaker bargaining position, it might make sense to work with other countries in the same region to present a common

position to foreign investors. Many regional groupings, including the Southern African Development Community (SADC), the East African Community (EAC), the Common Market for Eastern and Southern Africa (COMESA) and the Association of Southeast Asian Nations (ASEAN) all have their own model tax agreements, though not all of the countries in these blocs have ratified these agreements.⁹⁰

Ensuring that 'indirect transfers' can be taxed

When a company sells an asset to another company at a profit, the rise in the asset's value is commonly subject to capital gains tax (though some countries offer exemptions). Capital gains tax represents an important potential source of income for developing countries. This is particularly the case in the oil, gas and mining industries, where it is common for extraction rights worth billions of dollars to change hands, and in other high-value industries such as telecommunications.

Multinationals commonly place the ownership of their subsidiaries in developing countries in the hands of holding companies in tax havens. If the offshore holding company is sold to another investor, then the subsidiary in the developing country may change hands without the country concerned being able to charge capital gains tax. In some cases this is because the country's domestic law does not provide for taxation of capital gains. In other cases, there is a domestic law but it is overridden by the terms of a bilateral tax treaty.

Thus there is a strong case for developing countries to review their domestic laws and tax treaties and ensure that capital gains can be taxed not just on the sale of assets, but also of shares in companies, even where the transaction takes place offshore and several steps higher up the chain of corporate ownership. The IMF points out that to be able to tax an offshore transaction, a national tax authority needs to know about it in the first place. This could be addressed by requiring that the authority be notified of any asset disposals and by the sharing of tax information between countries.⁹¹

If BEPS won't solve the problem, what should developed countries do?

There are various measures that the governments of developed countries could take if they want to help developing countries collect a fairer share of tax on corporate profits. A cynic might argue that developed

countries have little interest in ensuring that 'their' multinationals pay more tax in poorer countries. But in addition to the principled argument that richer countries should help poorer ones, there is also the pragmatic argument that countries that collect more tax, including taxes on corporate profits, will depend less on foreign aid and spend more on public goods such as infrastructure and education, which also make a country more attractive for investment.

Developed countries could support a bigger role for the UN in international tax cooperation, review national tax rules and treaties and revise those that harm developing countries, ensure that their CFC rules cover profits shifted from third countries and require their multinationals to adopt public country-by-country reporting of their tax affairs.

Supporting a bigger role for the UN in international tax cooperation

A simple step that developed countries could take in the short term is to support the creation of an inter-governmental body on tax cooperation under the auspices of the UN, with the resources and mandate to address all the problems outlined in this briefing. The existing expert committee could support this new body, which would have much greater legitimacy than the OECD.

However, the UN could not be expected to rapidly solve the problems of international corporate taxation. A more powerful UN tax body would not automatically reconcile the interests of OECD countries, large middle-income countries and smaller, poorer developing countries: rather, it would provide a space for compromises to be negotiated between them. The great advantage of the UN over the OECD, however, is that all countries could be equally represented there. Even the smallest countries have some capacity to take part in UN meetings. Thus a continuous debate and negotiation of tax norms at the UN would have greater legitimacy than the OECD. It would also be able to take on problems that the OECD is unwilling to deal with, such as the imbalance between source and residence countries and the problem of tax competition.

Reviewing national tax rules and treaties to make them fairer

Developed countries should be willing to survey their own corporate tax rules and treaties in order to determine whether they are costing revenue to developing countries, then be willing to modify them if necessary to make them fairer. The IMF, OECD, UN and World Bank recommended in 2011 that G20

countries should undertake ‘spillover analyses’ of any proposed changes to their tax systems to determine whether they might be harming developing countries. These institutions recommended that where harm was found, the changes should be modified to try and reduce it and the analysis should be published so that developing countries can take measures to protect their own tax revenues.⁹²

The Netherlands agreed in 2013 to review its tax treaties with 23 least-developed countries, after criticism from civil society groups about the use of these treaties by multinationals, combined with the Dutch low-tax regime for holding companies, to reduce taxes in these countries.⁹³ Ireland, another big conduit jurisdiction for multinationals, was due to publish its own spillover analysis as this briefing was written in mid-2015.

Ensuring strong CFC rules which capture profit shifted out of third countries

The recent IMF paper on tax spillovers argues that with many OECD countries having adopted a territorial tax system, “tough CFC rules” would be an effective way of curbing harmful spillover effects from one country to another and mitigating pressure on countries to cut their tax rates.⁹⁴ This would be for the simple reason that strong CFC rules make it much less attractive for multinationals to shift profits into tax havens, since those profits still face taxation at the home-country rate.

Unfortunately, not all OECD countries have effective CFC rules. The UK deliberately weakened its rules in 2012, as noted earlier. The UK parliament’s committee for international development noted that the government minister responsible at the time “... did not deny that there would be a cost to developing countries. He stressed that the objective of the CFC rules was to protect UK tax revenues, not those of developing countries. Given that ... the government is also seeking to support revenue collection in developing countries, such a comment indicates a lack of joined-up thinking.”⁹⁵

This, in a nutshell, is the argument for stronger CFC rules – by deterring tax avoidance, they should help to backstop developing countries’ own efforts to raise more tax revenues. The more countries that do so, the greater the protection that is offered to all countries’ tax bases. For this reason, all developed countries (and developing countries which are residence countries for multinationals) ought to review the effectiveness of their CFC rules, toughening them if necessary and ensuring that they apply to corporate profits shifted from third countries.

Adopting public country-by-country reporting

Another reform that could be rapidly adopted in developed countries – and which would greatly help developing countries – is to require public country-by-country reporting by multinationals of their sales, profits, taxes and other key economic data, such as the number of employees and tangible assets in each country where they operate. Such information would make it much easier to see where there are imbalances between the places where a multinational’s substantial activities take place and the places where it books its profits and pays its taxes.

The OECD’s BEPS Project has recommended a useful template for this form of reporting which is close to the model originally proposed by the Tax Justice Network,⁹⁶ but there are profound shortcomings with the OECD’s proposed approach (see Figure 6). A much simpler and more effective approach would be that long proposed by civil society groups, which is to make the reports public in a timely way and without redactions.

The argument for making this information public is that doing so would enable the media, legislators, civil society watchdogs, economists and financial analysts to access it and act as a force for accountability, not only on multinationals but also on national tax authorities. Much of the recent impetus for reform of global corporate taxation has been created by these groups. By taking the concept of transparency and turning it into a limited and confidential form of reporting, the OECD is heading in the wrong direction.

There is a new legal requirement for financial institutions in the European Union to report a set of tax and financial data on a country-by-country basis which contains fewer types of data than that proposed by the OECD, but which would still provide a useful picture. A study by PwC for the European Commission found that the publication of these reports would be likely to improve public trust in the financial sector, “without ... having noticeable negative economic consequences, including the impact on competitiveness, investment and credit availability and the stability of the financial system”.⁹⁷

Some of the world’s biggest banks are based in the European Union. If they can publish country-by-country reports without being likely to incur any significant harmful effects, then there is no reason to think that multinationals in other sectors and other parts of the world could not do likewise.

PART THREE: Towards a global agreement to curb tax competition

If BEPS cannot address the problems faced by developing countries in taxing multinationals, then measures of the kind outlined in Part Two could help the former to shore up their corporate tax revenues. Ultimately there needs to be a new global settlement in international corporate taxation, one that is fairer to poorer countries and less open to abuse.

Whatever technical measures are adopted to make international taxation fairer to poorer countries, the ideology and practice of tax competition need to be tackled because of the downward pressure that tax competition places on revenue collection and the opportunities it creates for cross-border tax avoidance (which requires low-tax jurisdictions into which profits can be shifted).

In the form of tax incentives adopted by numerous developing countries, tax competition is visibly reducing the revenues that might otherwise be collected. In the form of spillovers from tax cuts in other countries, tax competition threatens to erode developing countries' corporate tax bases as the IMF's research has shown.

Tax competition will be hard to rein in, however, because the assumptions that underlie it are so entrenched: for instance, the assumption that tax cuts are justified because profit invested by a corporation in its own business will necessarily produce more value for society than the same amount of tax revenue spent on public goods by the state. This ignores the many benefits of corporate income taxes, above and beyond the public goods they pay for, which range from curbing inequality to backstopping personal income taxes, which the wealthy could otherwise avoid by incorporation.⁹⁸

A government's right to tax is among the most basic prerogatives of the sovereign state and the setting of taxes is a highly political question. For this reason, a genuinely inclusive and effective agreement between governments to curb tax competition seems unlikely for some years to come. There are steps that could be taken, however, to pave the way for it. An important start would be to recognise that the BEPS Project will not resolve the deeper problems of international corporate taxation. Other possible steps include a 'ceasefire agreement' by which countries

agree not to further undercut each other, and the implementation of common tax rules by groups of countries.

Recognising that BEPS will not make the deeper problems go away

The end of the BEPS Project in the second half of 2015 and the long period of implementation that is likely to follow may occupy the space that many governments have for thinking about international taxation. Some may want to assert that the problems of international corporate taxation have been dealt with for the time being. But BEPS is not designed to address deeper questions about the balance between source versus residence taxation, or the problem of tax competition itself. If not addressed, these problems will simply fester.

The governments of the G20 and OECD countries, and the OECD itself, ought to acknowledge on conclusion of the BEPS Project that its recommendations are not meant to be a final answer to all the problems of international taxation. The OECD's expertise can be a valuable resource for international tax cooperation, but an institution owned by 34 predominantly rich countries cannot attempt to speak for the common interest of 193 countries in any legitimate way. A more inclusive global tax body is needed, which engages with the deeper problems: in the absence of such a body, developing countries are justified in going their own way if they choose.

A 'ceasefire agreement' and common regional tax rules

One step towards a global agreement could be for countries (whether in particular regions or across the world) to make a commitment in principle not to take actions which would further lower effective tax rates on corporate income – a kind of 'ceasefire agreement'. Such a commitment might well be undermined by particular governments that are still wedded to tax competition, but it would be a useful starting point for further debate and might create peer pressure on those governments which undermine others.

An intergovernmental tax body at the United Nations could undertake to broker such a commitment within a certain number of years. The G20 is another forum whose members might come to see a common interest in taking a shared public position against tax competition. A prior condition, however, is a recognition that ‘fair’ and ‘harmful’ tax competition are hard to distinguish from each other in practice and will ultimately have similar effects on corporate revenues and therefore, on the fairness of the tax system to other taxpayers. Condemnation of ‘harmful’ tax competition – the preferred stance of many governments – is unlikely to be effective if it stigmatises certain kinds of tax breaks and allows others to grow unchecked.

Given the complexities of securing global agreement in the near future, tax cooperation across regions seems sensible as a prior step. There are already various examples of regional cooperation to set common tax rules, the most advanced being the legally binding directives of the European Union that govern the flows of capital between EU member states. In the wake of the LuxLeaks scandal, the European Commission has called for a revival of the Common Consolidated Corporate Tax Base (CCCTB), a scheme which was first mooted in 2001 and which stalled some years later due to lack of support among member states.

The CCCTB is a form of formulary apportionment that would be voluntary for multinationals to join. Each multinational would file one set of accounts in its headquarters jurisdiction, according to a standardised definition of taxable profit. Its profits would then be allocated to the EU member states in which they arise, based on a formula covering such factors as capital, labour costs and sales. The income would then be taxed in each member state at that country’s tax rate.

The creation of the CCCTB ought to disincentivise tax avoidance based on artificial corporate structures. A multinational would gain no advantage from basing its group finance company in Luxembourg, for example, since it would have to pay tax on its Europe-wide profits regardless of where in Europe these profits were booked. But the CCCTB would not prevent countries competing to offer lower tax rates for those activities reflected in the formula, so it might just change the character of tax competition rather than curbing it.

The CCCTB could be effective against tax competition if combined with a minimum European corporate tax rate. The latter seems far off for the time being,

however, since the EU’s constitutional rules require tax measures to be agreed unanimously by all 28 member states, including some of the world’s biggest corporate tax havens. It was reported in May 2015 that Germany and France had raised the idea of a common European corporate tax rate, to which the UK objected.⁹⁹

Even the common tax base itself might only be secured in a watered-down form, according to ActionAid’s conversations with diplomats in Brussels in early 2015. But slow, incremental progress towards greater European consensus does not seem impossible in the longer run, given that the logic of tax competition is ultimately self-defeating and public pressures on governments to reform corporate taxation are unlikely to go away.

The substance of a global agreement to curb tax competition

To be durable, an international consensus on curbing tax competition will need to be built up gradually by the kinds of measures described above. Such a consensus would need to be embodied in an international agreement, in order to exert pressure on jurisdictions (such as tax havens) that might otherwise choose to stay outside the consensus.

A global agreement to dissuade countries from undercutting each other on corporate taxation would take considerable time to negotiate. It would face a great deal of resistance from corporate vested interests, not to speak of the technical complexities of such an agreement. So it might make sense to start with non-binding codes of conduct, political statements of intent and the creation of working groups – not just at the United Nations but at international financial institutions – to build interest in the benefits of an agreement and move different views towards consensus.

An agreement to curb tax competition, by definition, has to curb downward pressure on effective corporate tax rates. This would mean covering all the different ways in which these rates can be pushed down, including the cutting of headline tax rates, special low rates for certain types of activity, or the narrowing of the base of corporate income on which tax is charged. Whatever its initial form, a global agreement would probably need to end up explicitly delineating a minimum effective rate of tax on corporate income, or engineering the circumstances in which an implicit global consensus can emerge around a minimum rate. A global minimum rate would need to be accompanied by a common understanding of the

corporate tax base (the kinds of income that can be taxed) to prevent countries from trying to undercut each other by excluding certain types of income from the base.

An approach that tries to designate specific tax practices as ‘harmful’, then roll them back, is unlikely to succeed in the long term because the definition of what is ‘harmful’ will always come down to negotiation in which the most influential or stubborn governments can lower the common denominator. Governments under pressure to drop one kind of tax break may thus simply adopt another. Ireland did so in late 2014 by agreeing to phase out its notorious ‘double Irish’ tax break, only to announce plans for a new tax break on profits from intellectual property. Or as the Bloomberg news agency neatly put it: “Goodbye Double Irish, hello Knowledge Box.”¹⁰⁰

Lengthy and arduous diplomatic efforts will be needed to secure a global agreement against tax competition. These efforts should not be wasted on reaching for an agreement that only covers some manifestations of the problem and not others. This is why such an agreement needs to put a floor under effective tax rates on corporate income as well as defining a common base. A global agreement could also be the vehicle for moving to unitary taxation in place of the arm’s length approach, treating multinationals as single global entities and apportioning profits to their different countries of operation according to a formula.

For a global agreement to succeed, it would need the support of major economies that are home to multinational corporations, including the OECD and G20 countries. An agreement would also need the participation of developing countries that are not part of these groupings, not just on the grounds of justice but also because any country left out of the consensus may be tempted to set itself up as a tax haven. With such diverse interests involved, progress towards an agreement will need to be gradual and inclusive, and is likely to be measured in years.

Some governments may worry that without the ability to cut tax rates, their economies will find it harder to compete for investment on other bases. Others may worry that ‘their’ multinationals will be disproportionately affected by a floor under effective tax rates. This is why an intermediate approach, which aims at changing attitudes over time and seeking out common ground, is more likely to be successful than attempting in the near future to come up with a blueprint for an all-encompassing agreement.

Making a global agreement stick

For a global agreement to be effective, it would need to successfully exert pressure on signatories to keep its terms. An agreement on curbing tax competition could combine an effective minimum rate and tax base with the use of a mechanism to deter countries from adopting tax practices which undercut this minimum rate and base.

One possible model could be the World Trade Organization’s Anti-Dumping Agreement, which empowers a country to take counter-measures against products which are being exported to it at less than the price which that product would fetch in its home market.¹⁰¹ By analogy, a country or group of countries whose tax bases were being undercut by the actions of another country – for example, a tax haven offering very low rates to multinationals – might be empowered to respond by imposing higher withholding taxes on transactions with that country.

A compliance mechanism applied centrally might be more appropriate, given that one country’s practice of tax competition may have harmful effects on numerous others. The agreement would need clear and strong provisions for establishing a dedicated compliance body and the process for agreeing membership. Ideally, the compliance body would oversee investigations, issue reports and rulings, as well as handling appeals.

There would need to be a non-exhaustive list of sanctions that could be invoked in cases of non-implementation of the body’s rulings. The body itself would need to be well-resourced to undertake investigations and follow up on rulings, so that the agreement would not be weighted in favour of wealthier countries. The most logical place to house such an agreement and its supporting institutions would be under the auspices of the United Nations, because of its legitimacy with governments.

CONCLUSION

It will take time to reach a new global settlement that ends the race to the bottom on corporate tax revenues. In the meantime, countries – especially the poorest – need revenue to build hospitals, schools and roads, and they cannot and should not wait for the world to catch up. They can step up action without delay to increase their share of revenues. Developed countries need to review their own rules and treaties too, with global fairness in mind, and be willing to revise them where needed.

Eventually, much more is needed than tinkering with the current system. The world needs to challenge and reconsider the logic of tax competition. Companies may compete, but countries ought to cooperate, rather than be forced by the absence of effective global governance to fight each other for tax revenue.

Ultimately, a new and inclusive global deal is needed to tackle tax competition and tax avoidance, a deal which would probably need to include minimum effective tax rates, a common tax base and the taxation of multinationals as single, global entities. For this to happen, there needs to be a genuinely inclusive and influential global institution for tax cooperation, where richer and poorer countries all have an equal say.

Current international corporate tax rules were developed piecemeal a century ago, when the world was still dominated by the Western colonial powers. The world has changed out of all recognition since then, and it is no longer possible, let alone acceptable, for the global rules to be shaped for the benefit of the few. Developing countries expect a fairer deal in the global economy, and people everywhere want to see a more equal world. The old economic orthodoxies are toppling. Now is the time for a bold new approach to corporate taxation.

RECOMMENDATIONS

The governments of developing countries could:

- Review tax incentives for investors and scrap those whose costs in foregone revenue are not clearly shown to be outweighed by their benefits to the economy and society.
- Adopt unilateral measures to protect their tax bases, such as disallowing excessive tax deductions by corporations and requiring them to use simpler methods of transfer pricing.
- Review and renegotiate their bilateral tax treaties to enhance their source taxing rights and be very wary of signing new ones. As a last resort, harmful treaties could be cancelled.
- Continue to press for an intergovernmental body for tax cooperation at the United Nations, with sufficient resources and a broad mandate that extends to source and residence taxing rights, and tax competition.

The governments of developed countries should:

- Support the creation of an international body for tax cooperation at the United Nations, with a broad mandate and sufficient resources.
- Review their own tax rules and treaties and revise them where they are harming poorer countries.
- Ensure their anti-tax haven (controlled foreign companies, CFC) rules are effective and apply to profits shifted by multinationals out of third countries, not just the developed country itself.
- Require multinationals to publish country-by-country reports on their turnover, profits, taxes and key economic data such as numbers of employees and tangible assets.

All governments should:

- Stop trying to undercut each other's tax revenues by lowering effective tax rates for multinationals, through whatever means.
- Work in the longer term towards a global agreement to curb corporate tax competition, which would probably require a minimum effective tax rate and common tax base, and consider a shift to unitary taxation.

1. UNCTAD. World Investment Report 2015. June 2015. Page 200.
2. International Monetary Fund. Spillovers in international corporate taxation. Staff working paper. May 2014. Page 20.
3. ActionAid UK. Close the gap! The cost of inequality in women's work. March 2015.
4. International Centre for Tax and Development. Working Paper 19. The ICTD Government Revenue Dataset. September 2014. Page 36.
5. ActionAid. Tax justice: the domestic perspective. A synthesis of studies of the tax systems in five developing countries. July 2013.
6. World Bank. Financing for Development Post-2015. 2013. Page 9. Figure 2.1
7. OECD revenue statistics. Tax revenue as % of GDP. Accessed at <http://stats.oecd.org/index.aspx?DataSetCode=REV>.
8. Financial Times. Uganda joins African wave of GDP rebasing and gets 13 per cent boost. 1st December 2014.
9. IMF. Spillovers in international corporate taxation. May 2014. Page 7. Figure 1.
10. ActionAid. Tax justice: the domestic perspective. A synthesis of studies of the tax systems in five developing countries. July 2013. Page 8.
11. ActionAid. Sweet nothings. The human cost of a British sugar giant avoiding taxes in southern Africa. February 2013. Page 3.
12. IMF. Spillovers in international corporate taxation. May 2014. Page 6.
13. Southern African Development Community. Memorandum of Understanding on co-operation in taxation and related matters. August 2002.
14. Private conversations between ActionAid staff and senior staff at large accounting firms.
15. For a recent analysis of governments' approaches to tax competition, see Financial Times. Countries slow race to bottom on tax competition. 4th May 2014.
16. World Bank/PwC. Paying taxes 2015. For example, Page 2 notes that, "Reforms continue to be made in Africa, while progress is less evident in South America. South America now has the highest average time to comply and Total Tax Rate."
17. International Consortium of Investigative Journalists. Leaked documents expose global companies' secret tax deals in Luxembourg. 5th November 2014.
18. ActionAid UK. Addicted to tax havens. The secret life of the FTSE 100. October 2011.
19. New York Times. How Delaware thrives as a corporate tax haven. 30th June 2012.
20. UNCTAD. World Investment Report 2015. Page 199.
21. UNCTAD. World Investment Report 2015. Page 189.
22. OECD. OECD urges stronger international co-operation on corporate tax (media release). 12th February 2013.
23. European Commission. Staff Working Document. Technical analysis of focus and scope of the legal proposal accompanying the document. Proposal for a Council Directive amending Directive 2011/16/EU as regards exchange of information in the field of taxation. 18th March 2015. Page 16.
24. UNCTAD. World Investment Report 2015. Page 200.
25. IMF. Base erosion, profit shifting and developing countries. IMF Working Paper. 29th May 2015. Page 20. Table 6.
26. IMF. Spillovers in international corporate taxation. Page 6.
27. ActionAid. Calling time. Why SABMiller should stop dodging taxes in Africa. 2010, updated April 2012.
28. ActionAid. An Extractive Affair. How one Australian mining company's tax dealings costs the world's poorest country millions. June 2015.
29. Illicit financial flows. Report of High Level Panel on Illicit Financial Flows from Africa. February 2015. Page 79.
30. Global Financial Integrity. Illicit financial flows from developing countries: 2003-2012. Page 8. Table D.
31. Reuters. Factbox: Apple, Amazon, Google and tax avoidance schemes. 22nd May 2013. Financial Times. Amazon starts to book UK sales in Britain. 22nd May 2015.
32. Francis Weyzig. Evaluation Issues in Financing for Development. Analysing effects of Dutch corporate tax policy on developing countries. Netherlands Ministry of Foreign Affairs. November 2013. Page 12.
33. ActionAid. Deloitte in Africa – Advising big businesses on how to avoid tax in some of the world's poorest countries. November 2013.
34. IMF. Territorial vs worldwide corporate taxation: implications for developing countries. IMF Working Paper. October 2013. Page 4.
35. Citizens for Tax Justice. Offshore shell games 2014. Page 10.
36. Deloitte. Withholding tax rates 2015.
37. Michael Lennard. The UN Model Tax Convention as compared to the OECD Model Tax Convention. Current points of difference and recent developments. Asia-Pacific Tax Bulletin. January-February 2009.
38. Letter to the Financing for Development Office of the UN from the Central Board of Direct Taxes, Ministry of Finance, Government of India. Dated 12th March 2012. Accessed at <http://www.un.org/esa/ffd/tax/2012ICTM/LetterIndia.pdf>
39. Information obtained by civil society groups in mid-2015.
40. OECD. Public Discussion Draft. BEPS Action 3. Strengthening CFC Rules. 12th May 2015. Page 12.
41. Tax Journal. Corporation tax at 5.5% is 'almost government-approved avoidance', says tax adviser. 17th April 2012.
42. ActionAid. Give us a break. June 2013. Page 8.
43. IMF research quoted in ActionAid. Give us a break. 2013. Page 6. Table 1.
44. ActionAid International/Tax Justice Network – Africa. Tax competition in East Africa: A race to the bottom? April 2012. Page iv.
45. House of Commons. Committee of Public Accounts. Tax reliefs. Third Report of Session 2014. Summary.
46. ActionAid. Give us a break. Page 4.
47. Supporting the development of more effective tax systems. A report to the G20 Development Working Group by the IMF, OECD, UN and World Bank. Page 19.
48. IMF. Revenue mobilization in developing countries. Staff paper. 8th March 2011. Page 35.
49. IMF. Spillovers in international corporate taxation. Page 20.
50. Christine Lagarde. The Caribbean and the IMF – building a partnership for the future (speech). 27th June 2014.
51. United Nations Practical manual on transfer pricing for developing countries. 2013. Page ii.
52. HM Revenue and Customs. Transfer pricing statistics: 2013 to 2014. 6th March 2015.
53. ActionAid personal communication. March 2014. BEPS Monitoring Group response to OECD BEPS report on transfer pricing comparability data and developing countries. March 2014.
54. A. Waris. Rwanda. Understanding transfer pricing. IBFD International Transfer Pricing Journal Vol 21. No. 1. January/February 2014.
55. Declaration of the Independent Commission for the Reform of International Corporate Taxation. Statement of Principles. June 2015.
56. International Tax Review. Location-specific advantages. India and China. 23rd January 2014.
57. KPMG. Global Transfer Pricing Review. Brazil. 2013.
58. PwC. 'Sixth method' raises transfer pricing concerns in developing countries. 29th January 2013.
59. OECD. Addressing base erosion and profit shifting. 2013. Page 13.
60. Michael C. Durst. The tax policy outlook for developing countries: reflections on international formulary apportionment. International Centre for Tax and Development Working Paper 32. February 2015.
61. G20 Leaders' Declaration. 6th September 2013.
62. OECD. Developing countries to play greater role in OECD/G20 efforts to curb corporate tax avoidance. 12 th November 2014.
63. ActionAid. The BEPS Process. Failing to deliver for developing countries. 16th September 2014.
64. OECD. Action plan on base erosion and profit shifting. 2013. Page 10.
65. Krishen Mehta. How developing countries can take control over their tax destinies. 9th July 2014.
66. The East African. Kenya in bid to retire tax breaks to foreign investors. 4th April 2015.
67. The East African. Tanzania's law amendment seeks to boost tax collection. 17th May 2014.
68. Manila Times. PH needs updated tax incentives – DOF. 11th March 2015.
69. See footnote 54 above.
70. Report of the High Level Panel on Illicit Financial Flows from Africa. January 2015. Page 71.

71. PwC. 'Sixth method' raises transfer pricing concerns in developing countries. 29th January 2013.
72. BEPS Monitoring Group. Comments on BEPS Action 10. 10th February 2015.
73. PwC. Worldwide tax summaries. Corporate Taxes 2014/15. Peru.
74. South African Revenue Service. Request for public comment for incorporation into forthcoming 2013 Tax Laws Amendment Bill: proposed limitations against excessive interest tax deductions. 29th April 2013.
75. EY. Worldwide Corporate Tax Guide. 2015.
76. Reuters. Panama and Colombia to negotiate tax information-sharing deal. 21st October 2014.
77. LiveMint. India-Cyprus tax treaty talks at an impasse. 15th September 2014.
78. PwC. Multinational organisations operating in Africa need to consider the tax treatment of their transactions upfront – or face significant tax exposure, warns PwC. 31st March 2014.
79. Research by the IBFD for the UN expert committee published as The UN Model in Practice 1997-2013. Bulletin for International Taxation. March 2014.
80. UN Economic and Social Council. Committee of Experts on International Cooperation in Tax Matters Report on the tenth session (27-31 October 2014). ActionAid attended this meeting as an observer.
81. Heather Self. Australia's answer to the diverted profits tax. Tax Journal. 22nd May 2015.
82. Martin Hearson. Learning from past mistakes in tax and investment treaties. 17th October 2014. Accessed at martinhearsen.wordpress.com.
83. IMF. Spillovers in international corporate taxation. Page 27.
84. Francis Weyzig. Evaluation Issues in financing for development. Page 67. SOMO. Should the Netherlands sign tax treaties with developing countries? June 2013. Page 40. Table 2. The SOMO estimate applies to dividends and interest payments.
85. IMF. Spillovers in international corporate taxation. Page 28.
86. First Post. India, Mauritius to curb 'abuse' of double tax avoidance treaty. 13th March 2015. Business Day. South Africa urged to finalise renegotiation of Mauritius tax treaty. 29th December 2014.
87. The East African. Rwanda and Mauritius sign new tax deal. 9th November 2013.
88. Daily Monitor. Govt suspends double taxation pacts. 6th June 2014.
89. Reuters. In tax case, Mongolia is the mouse that roared. 16th July 2013.
90. The East African. East Africa edging closer to adopting single taxation regime. 7th March 2015.
91. IMF. Spillovers in international corporate taxation. Page 30.
92. IMF, UN, OECD, World Bank. Supporting the development of more effective tax systems. Pages 27-28
93. Financial Times. Netherlands to review tax treaties with least developed countries. 6th September 2013.
94. IMF. Spillovers in international corporate taxation. Page 38.
95. House of Commons. International Development Committee. Tax in developing countries: Increasing resources for development. Fourth Report of Session 2012-13. Page 20.
96. Richard Murphy. Country-by-country reporting. Tax Justice Focus. First quarter 2014 Volume 9 Issue 1.
97. Study prepared by PwC for European Commission DG Markt. General assessment of potential economic consequences of country-by-country reporting under CRD IV. Final report September 2014. Page 9.
98. For a detailed defence of corporate income taxes, see Tax Justice Network. Ten reasons to defend the corporation tax. 18th March 2015.
99. Daily Telegraph. France and Germany behind plans for 'common EU corporation tax'. 26th May 2015.
100. Bloomberg. Goodbye double Irish, hello knowledge box. 15th October 2014.
101. Understanding the WTO: the agreements, anti-dumping, subsidies, safeguards, contingencies, etc. Accessed at www.wto.org.

ActionAid

33-39 Bowling Green Lane
London EC1R 0BJ

ActionAid UK is a registered charity
in England and Wales (274467) and
Scotland (SCO45476)

www.actionaid.org