Funding the Future

Should developing countries turn their backs on the OEC...

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Much of my commentary on the OECD's BEPS programme has so far concentrated on its impact on the UK and other developed countries. That is not surprising since that is the audience it was written for. However, it has always been developing countries that have been at the heart of much of my concern on this issue, and they are the focus of the Tax Justice Network's campaigning. So what of BEPS and such countries?

I have to say that, as most campaigning organisations working in this area agree, the story of BEPS and developing countries is overall a pretty sorry tale. In its February 2013 report the OECD relegated the issue to the final page of a near 90 page document. This time, no doubt having heard the collective NGO outcry, they have tried to do better but there is little in this report that is greatly encouraging.

Corporate taxes are incredibly important to many developing countries. When many in their populations are too poor to pay any taxes and when corruption undermines much of the local tax base from commerce (and this fact has to be recognised at present) then the revenues to be earned from multinational companies form a significant part of the tax base of these states. In that case the base erosion that is now well documented due to transfer mispricing out of these countries on royalties, management services, interest, insurance and other charges levied on an intra-group basis, usually from tax haven subsidiaries within the same multinational entity, is of massive concern to these states and forms a major part of the illicit flows that prevent the provision of adequate services by many governments, undermining democracy and blighting many lives over succeeding generations.

We have argued for fundamental reform on behalf of these countries. First we have argued for full country-by-country reporting so that just what is recorded in these countries can be known in the first instance; the aim being to try to embarrass companies into locating their profits there.

Second, we argue for country-by-country reporting so that these states have the data to see where the sums flowing from their shores go to, and how profitable the other side of the transaction might be for the multinational corporation in question. This then provides a significant part of the data needed to challenge whether the company's own profit allocation is reasonable or not, and so forms the basis for deciding whether to mount a transfer pricing challenge.

And third, we have argued that these countries must be given the right to tax at source the profits arising in their countries and that they be provided with all the help they need to do just that. This would be so much more powerful than the current culture of aid dependency.

In my opinion little is being done to really achieve this goal in the BEPS programme. First, unitary taxation which would emphatically help these countries by ensuring profits are re-apportioned to them has been rejected. They stood to be potentially significant winners from unitary taxation but although supported by many, including the FT, as the economically logical way to tax companies this approach has been rejected by BEPS as "infeasible", for which read big companies and the USA did not like it.

Second, no significant bias to source based taxation has been introduced into the tax system to help them, and the bias inherent in OECD double tax treaties towards developed countries therefore remains. Residence based taxation models remain predominant in OECD thinking even as major countries, like the UK, abandon this approach to taxing and move to a territorial model if tax, which means the OECD model will in future simply provide yet more opportunities for tax abuse.

Third, the hopes for country-by-country reporting arising from BEPS look like they may be limited as a result of lobbying by multinational companies and the USA, both of whom carry more clout than developing countries on this issue.

Fourth, there is no obvious expansion of technical assistance in BEPS - just warm noises.

That is not to deny, of course that some moves might help. So, for example, denying tax relief on payments to tax havens gets luke-warm endorsement in the BEPS report, as does the extension of controlled foreign company rules - not that developing countries have many of these. These would help if the developing country had the ability to ensure they are enforced, but it is not clear they have. The basic question of whether data to ensure models of taxation in this area - which proper tax based country-by country reporting would greatly facilitate because it highlights intra group transactions by requiring their separate disclosure - has to be asked.

With all this noted there are still three other obstacles to progress on this issue of ensuring developing countries get their fair share of tax. The first is that developed countries, such as the UK, are continuing to develop tax competitive practices, such as virtually abandoning controlled foreign company rules. This practice is seriously harming developing countries because the profits that now leak from those developing countries to tax havens are now virtually guaranteed not to be taxed anywhere as multinational companies increasingly expect favour from the tax system.

Second, the downward pressure on tax rates means developing countries cannot forever remain out of line on this issue, so threatening their tax revenues, yet again.

Lastly, many of these countries also face the near insuperable, but little mentioned, problem of having signed forward tax agreements (or 'tax stability clauses') with the companies that exploit their mineral resources that mean that they cannot apply changed tax laws to subsidiaries of these multinational companies for many years to come, whatever their domestic law, international agreements or the OECD say.

The inevitable consequence of all these factors is that for many years to come developing countries are not going to see a change in their fortunes on corporation tax. So what should they do?

I think the obvious answer is to say in the first instance that the developed world has failed the developing world on this issue. Developed countries have sought to impose a Washington Consensus model of tax on the developing world but have failed to make sure it functions properly. As result there has been a demand to replace tariffs with profits based taxation but as the tariffs have gone the profits have not followed. The developing world can fairly say the OECD has recognised he problem of the developing world in this area, and has now walked away from it. The obvious reaction would be for developing countries to walk away from the OECD as a result.

in that case there is an obvious need for developing countries to have a serious rethink of their tax bases if the revenues needed to ensure that development can really occur are to be raised. Since it remains true that people will remain poor for some time to come and corruption is not going to disappear overnight the remaining option is to return to old favourites that have, supposedly, been discredited by the neoliberal mantra of free trade but which have the potential to raise the sums required in cost effective fashion.

The first of these is tariffs. The free trade lobby does, of course, oppose such taxes, but does so from a position of hypocrisy. No developed country got to its current economic state without creating significant tariff barriers.

Second, enhanced turnover taxes are necessary on minerals and other natural resource exploitation. They work. It's as simple as that.

Lastly, land value taxation may well have a role to play when so much of what is happening in developing countries is about control of natural resources in a wide variety of forms.

None of these taxes meets the Washington Consensus specification for a desirable tax. I have to say the time to worry about that has passed. As far as developing countries are concerned the chance of effectively taxing profits arising within their domains at any time in the reasonably foreseeable future seems remote because no one is taking the necessary steps to help them determine just what those profits might be. In that case recourse to older, more trustworthy, income generators is essential if these countries are to serve the interests of their own populations.

I do not for a minute in saying this suggest that the attempt to have corporate taxes properly apportioned to developing countries should come to an end. Far from it: these countries have a right to have the profits apportioned to their jurisdiction if there are reasonable grounds for thinking they arose there. But pragmatism has a role in development. And that means that if the wait for justice on corporate profits taxation looks to be an exercise in the deferral of expectation too far into the future then pressing humanitarian need requires alternative action now, and there are taxes that can fill the brink. The time to explore those alternative options may well have arrived, and assistance in ensuring they too are paid might now be an appropriate focus for technical assistance.

In summary, the developed world cannot ignore the tax needs of their developing country partners and then demand they deliver the taxes the developed world wants. That's just unreasonable, but is what has happened. Coordinated developing country response is now needed.