

## The OECD fails to rise to the challenge

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I have already explained that the OECD has in its new Base Erosion and Profits Shifting (BEPS) report [has acknowledged that the arguments of the tax justice movement](#) have been right on the issue of international tax avoidance by multinational corporations [and that their own past attempts to deal with this issue have been inadequate](#). I do, of course, welcome both admissions.

That welcome is, however, muted. The third chapter of the OECD report lays out an action plan that the OECD says will address the issues it has acknowledged exist. Unfortunately I doubt it will deliver. When there are 15 action points that it details that seems churlish but the concerns come down to three things, fundamentally

First is this comment in the report:

*In the area of transfer pricing, the rules should be improved in order to put more emphasis on value creation in highly integrated groups, tackling the use of intangibles, risks, capital and other high-risk transactions to shift profits. At the same time, there is consensus among governments that moving to a system of formulary apportionment of profits is not a viable way forward.*

The inevitable consequence of this, as the Tax Justice Network has said in its response to the BEPS report, is that:

*It does not point to a new approach towards taxing transnational corporations (TNCs), but aims at strengthening the existing rules. It therefore does not address the fundamental flaw in the current system, which attempts to tax TNCs as if they were separate entities operating independently in each country. Since in reality they are unified firms under central direction, we consider that the only effective way to tax them is using a unitary approach, as we have explained in [our previous Briefing](#), and earlier reports. This is understood and accepted by many tax experts, even some at the OECD.*

In other words, the OECD has said there is a fundamental problem in the international

tax system that its approach to date has not addressed that threatens the credibility of tax systems and government revenues as well as social justice nationally and internationally but that all it will do in response is tweak the existing arrangements that have failed to deliver fair taxation to date. From the outset this report is, therefore, flawed.

The arm's length transfer pricing system is fundamentally flawed by design by assuming groups of companies are made up of separate entities when that is not the case. Nothing but the eventual replacement of this flawed system will overcome this problem. However, as someone said at a meeting I attended this week, asking the OECD to give up arm's length pricing is a bit like asking the church to give up belief in God. It's deep in its DNA and for the time being immovable. When the OECD has acknowledged that the system is broken then this is at the same time clear indication of a lack of willing to fix it properly, and that undermines all this new work schedule seeks to do.

Second, it is important to note that there are some aspects of the work programme that are welcome. Measures to strengthen the Controlled Foreign Corporation (CFC) rules fall into this category, although in that context it's important to note that the current UK government has done all it can to undermine them in this country. In addition, proposed work on limiting the deductibility of interest and other payments to related entities in low-tax or no-tax jurisdictions, ending arrangements that facilitate tax treaty-shopping, such as the 'Dutch sandwich' highlighted in the Google case and reforming the concept of permanent establishment, abused by so many IT companies, are all steps forward. So is work on hybrid entities.

I should add that the thirteenth work stream, on transfer pricing documentation, says:

*The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.*

Without using the term this appears to be an explicit endorsement of the demand for country-by-country reporting issued by the G8, and naturally I welcome that. However critically, despite all the talk of transparency there is none in this document on most tax processes, and certainly not on public reporting. The use of country-by-country reporting referred to here is for tax purposes and not for publication. That is a significant failing on its part and will undermine confidence in the proposed processes.

But, and it's a very big but, my third point is to sound an alarm bell. The work programme has been split into 15 parts. Knowing how the OECD works I suspect a working party will be established on each. Tax authorities and big business will dominate each working party. There will be little or no developing country

representation I am afraid, and that will undermine the credibility of this work which will, inevitably, as a result focus on the needs of developed countries and multinational corporations. There will also, almost certainly, be little involvement from civil society and I am quite sure the OECD will not fund any. That is, again, a massive oversight. If the outcomes of this proposal are to counter the dissatisfaction throughout the political system with multinational corporation taxation then engagement with civil society is essential, but is under-invested in by the OECD.

But that is not important as the fact that now 15 works streams have been identified the OECD will argue that any representations made to it have to fit into one of those fifteen work streams or they will not be able to address them. That, though, will be very convenient for it. The real problem with the whole OECD approach in this document is that it is fundamentally flawed. But, having spread the work 15 ways the OECD will now say representations to that effect have no place to fit into the process - and so can be laid aside. In other words, the OECD is seeking to play a game of divide and rule by setting the rules of engagement as being solely on its terms from the outset on this issue and that will be the biggest threat to the credibility of this work.

You can seek to reform something that does not work for as long as you like, but if the flaw is fundamental no amount of tweaking will remedy the central fault. And that is the trap into which the OECD has fallen.

I am not sure if it can or even wants to get out of this trap. And whilst the OECD report is to be welcomed for what it says, especially in its first two chapters where it clearly recognises the issues that it must face, its failure to face them adequately in its work programme suggests that the problems in international tax will not be going away soon - which is why national agenda may become as important.

I'll say more on the later soon.