The U.S. and BEPS: Hurry Up and Slow Down

By Jason B. Freeman, JD, CPA | Column Editor

The Organization for Economic Cooperation and Development's (OECD) Base Erosion and Profit Shifting (BEPS) initiative is headed for the home stretch. Whether it will cross the finish line, however, remains to be seen. In only a few short months, the OECD will issue final, comprehensive reports and a plan to implement its BEPS initiative – the culmination of an ambitious two-and-a-half-year effort to overhaul the global tax system. The major concern: eliminating double *non*-taxation, or so-called "stateless" income, and putting an end to the perceived threat that multinational corporations are artificially (and improperly) shifting tax profits across borders to avoid taxation.

What Exactly is the BEPS Project?

The BEPS Project is an attempt to develop and implement a new global consensus on the rules of international taxation. The OECD, urged by the G-20, launched the project to measure, address and determine how to prevent the erosion of tax bases through profit-shifting schemes. With its sights set squarely on ending cross-border tax arbitrage and fundamentally reforming the international tax system, the initiative is grandiose and sweeping in its scope.

The project has been spurred by a concern that existing international tax rules and treaties, largely formulated in a different era, have failed to keep pace with an increasingly borderless business environment and an expanding (if not now *fundamentally*) digital economy. Stakeholder countries are particularly concerned that sophisticated multinational corporations are exploiting gaps in current international tax rules – artificially shifting profits to low-tax jurisdictions and compromising the integrity and fairness of the current system in the process. The OECD hopes to close such gaps and align the taxation of income with the underlying economic activity that generates it.

Despite its broad scope, the BEPS project has moved at warp-speed, at least in terms of international tax policy development. Less than three years after the G-20 commissioned the project, the OECD is now poised to publish its final set of reports and to seek implementation of its recommendations soon thereafter.

It remains to be seen whether the OECD's recommendations will be embraced and implemented with a speed and fervor equal to their undertaking – indeed, whether they will be implemented at all. The OECD will face serious hurdles converting its aspirational guidance into widespread enforceable, administrable rules of law.

The Need for International Support

For one thing, the initiative requires substantial international buy-in. And there is good reason to doubt whether that buy-in currently exists, particularly from some key countries. There are signs that the United States' enthusiasm for the project is waning, as key legislators have recently questioned its efficacy, Treasury officials have expressed disappointment with the project, and stakeholders have raised concerns over its potential negative impact on U.S.-based multinationals. Some other countries have recently undertaken their own domestic tax initiatives that undermine the OECD's call for coordinated action, signaling that they may, to some extent, go their own way.

How Big of a Problem is BEPS, Really?

It is also – and this is a big point – fundamentally unclear just how big a problem BEPS really is. To be quite candid, the jury is still out on the underlying empirical basis for the central proposition behind the movement: that governments are losing substantial corporate tax revenues because multinationals are improperly shifting profits.[1] The international buzz on the issue reached a fever pitch during the widespread fiscal austerity that followed the Great Recession, an environment that proved a fertile breeding ground for political and social backlash against a handful of multinationals, and that backlash has really been the anecdotal foundation for a movement to fix a problem whose magnitude is not clear.

Legal Hurdles

Finally, there are serious legal impediments to implementing the BEPS proposals. Currently, there are more than 3,000 bilateral tax treaties across the globe.[2] Treaty networks would have to be amended or modified (or circumvented) to implement the BEPS initiative. Certainly this could be accomplished, but it would be no small undertaking.

The OECD, for its part, is proposing a multilateral instrument that would implement its BEPS plan in a comprehensive manner, sidestepping the practical and administrative difficulties of reworking hundreds, if not thousands, of bilateral treaties. Notably, however, the United States has not joined the 80 or so countries that are engaged in drafting that instrument, possibly signaling that it may not sign on.

BEPS and United States Tax Reform

The ongoing BEPS negotiations and soon-to-be-delivered

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final OECD reports come at a time when Congress is actively working toward comprehensive tax reform. The two efforts, however, have largely proceeded on parallel tracks and, to this point, have not been particularly coordinated. But the BEPS negotiations and comprehensive U.S. tax reform are integrally related; indeed, they may ultimately be one and the same.

The BEPS initiative also shines a bright spotlight on the need for U.S. tax reform. The United States, which boasts the highest corporate tax rates among OECD countries, places U.S. companies at a competitive disadvantage in the global marketplace. Taxes are, after all, a major cost of doing business. And that higher cost, the logic goes, ultimately hurts U.S. workers and shareholders. U.S. companies also face taxation on repatriated foreign earnings, a policy that has deterred them from bringing home an estimated $2 trillion that they have indefinitely parked overseas. Clearly there are significant policy issues that hang in the balance here; and clearly there are good reasons to support international and corporate tax reform of some kind.

A Little History and Perspective

Many of the international tax rules and norms currently in place originated in principles that were developed in the 1920s by the League of Nations and, perhaps to a lesser extent, the International Chamber of Commerce. The principles formulated in that era were developed primarily to address the threat of double taxation. That is, of course, in many respects, the polar opposite of the current concern with double *non*-taxation.

The shift in focus is a reflection of the fundamental underlying economic changes that have taken place; it is also emblematic of the distance between then and now. Indeed, much has changed since our current rules and norms were developed. Countries have jockeyed for and traded global economic positions, changing their respective bargaining power in the process; creditor nations have become debtor nations, and vice versa; and the global economy has undergone a digital revolution that raised the level of interconnectedness to heights unforeseeable by the policymakers of the 1920s. Tax systems interact now more than ever before; but sometimes, it seems, they still fail to interact where they should.

The Current Landscape

So where does the United States currently stand with respect to the BEPS debate? The U.S. has shown signs that its enthusiasm for the OECD's BEPS project is waning. In a July speech on the Senate floor, Sen. Orin Hatch, the chair of the Senate Finance Committee, expressed "serious concerns" about the BEPS project.[3] Hatch and Rep. Paul Ryan, the chair of the House Ways & Means Committee, also jointly wrote to "remind the Treasury Department that it has the ability to refrain from signing on to the BEPS final reports," and that they "expect [Treasury] to do just that if doing so protects the interests of the United States and of U.S. persons."[4] Those are hardly words that indicate Congressional approval of the BEPS project's current direction.

Together, Hatch and Ryan, the chairs of Congress's two tax-writing committees, expressed their reservations with the BEPS process, stating that they "are troubled by some positions the Treasury Department appears to be agreeing to as part of the [BEPS] project."[5] "Regardless of what the Treasury Department agrees to as part of the BEPS project," they warned, "Congress will craft the tax rules that it believes work best for U.S. companies and the U.S. economy."[6] This rhetoric sets an interesting backdrop for current efforts to enact comprehensive tax reform in this context.

The Treasury Department, for its part, has expressed frustrations too. Robert Stack, the Treasury Deputy Assistant Secretary for International Tax Affairs and the lead United States delegate to the OECD Committee on Fiscal Affairs, lamented that he is "extremely disappointed in the output and our collective failure in the BEPS project to do more and do better work than we've done."[7] Stack has been critical of the BEPS project's breakneck pace and the adoption of subjective governing standards on key issues that apply little more than, in his words, the "pornography test"[8] – a reference to Justice Potter Stewart's famous "I know it when I see it" test that is infamously difficult to administer with predictability.

Many others have expressed concerns that the United States stands to be a net loser from the BEPS initiative, that the effort is a European job-and-revenue grab that will create a migration of jobs and revenues from the United States to European countries with more competitive corporate tax systems. Many have also raised concerns about the confidentiality of sensitive taxpayer data that would be required to be reported to other countries through the OECD's recommendation for country-by-country reporting provisions. There is growing concern that requiring U.S. multinationals to provide so-called "master file" tax information to foreign tax collectors (as would be required) would come with substantial data-security risks and inadequate assurances of confidentiality. There is also a concern that requiring U.S. multinationals to provide sensitive financial data to foreign countries would put them at a competitive disadvantage, particularly where they compete with state-owned enterprises owned or backed by the very countries they would be required to report to.

On the whole, current barometers indicate that the U.S. is lukewarm on the BEPS project. However, policy is politics and politics is policy, and they are subject to change, so our course and direction remains to be seen.

A Measured Approach

So where do we go from here? Undoubtedly, by the time this goes to press, there will be new reflections and insights on the rapidly evolving BEPS debate. Never before, it seems, has the development and change of such truly fundamental and comprehensive tax policy moved with this speed and self-certainty to fix a problem that, even its authors begrudgingly acknowledge, is uncertain in scope. That dynamic underscores the fact that the OECD's BEPS initiative may be outpacing itself. It is waging war on a problem with unknown dimensions, and we might do better to slow down, step back, and take better stock of that problem before wholesale adopting the OECD's final tenets.

While it would be wrong to say that the BEPS initiative is a solution in search of a problem, it is quite possible that it may simply not be the best solution to that problem. At this point, it is hard to say. In a space as complicated and multifaceted as the intersection between and among sovereign countries' international tax regimes, even minute changes in policy by some countries can wreak havoc. Certainly major changes could do even more damage than good. And that favors a cautious, measured approach – an approach that, so to speak, separates the baby before we toss the bathwater. ■

Footnotes

1. Indeed, the OECD, in an early report on the subject, acknowledged that "it is difficult to reach solid conclusions about how much BEPS actually occurs." While acknowledging that "[m]ost of the writing on the topic is inconclusive," the OECD maintains that "there is," nonetheless, "abundant circumstantial evidence that BEPS behaviors are widespread." *Addressing Base Erosion and Profit Shifting*, OECD (2013), p. 15.
2. *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties*, OECD (2014), p. 11.
3. *In Speech, Hatch Outlines Concerns with OECD International Tax Project*, Senate Committee on Finance, July 16, 2015.
4. June 9, 2015 Letter from Sen. Orin Hatch and Rep. Paul Ryan to Secretary of the Treasury.
5. Id.
6. Id.
7. *U.S. 'Extremely Disappointed' in DPT and BEPS Output, Stack Says, TaxAnalysts*, June 15, 2015.
8. Id.

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