THE OECD BASE EROSION AND PROFIT SHIFTING (BEPS) PROJECT

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THE OECD BASE EROSION AND PROFIT SHIFTING (BEPS) PROJECT

TUESDAY, DECEMBER 1, 2015

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON TAX POLICY,
Washington, DC.

The Subcommittee met, pursuant to notice, at 10:04 a.m., in Room 1100, Longworth House Office Building, Hon. Charles W. Boustany, Jr. [Chairman of the Subcommittee] presiding.
[The advisory announcing the hearing follows:]
Chairman Boustany Announces Hearing on
The OECD Base Erosion and
Profit Shifting (BEPS) Project

Congressman Charles Boustany (R–LA), Chairman of the Committee on Ways and Means Subcommittee on Tax Policy, today announced that the Subcommittee will hold a hearing on the OECD BEPS project final recommendations and its effect on worldwide American companies. The hearing will take place on Tuesday, December 1, 2015, in Room 1100 of the Longworth House Office Building, beginning at 10:00 a.m.

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit written comments for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://waysandmeans.house.gov, select “Hearings.” Select the hearing for which you would like to make a submission, and click on the link entitled, “Click here to provide a submission for the record.” Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word document, in compliance with the formatting requirements listed below, by the close of business on Tuesday, December 15, 2015. For questions, or if you encounter technical problems, please call (202) 225–3625 or (202) 225–2610.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be submitted in a single document via email, provided in Word format and must not exceed a total of 10 pages. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. All submissions must include a list of all clients, persons and/or organizations on whose behalf the witness appears. The name, company, address, telephone, and fax numbers of each witness must be included in the body of the email. Please exclude any personal identifiable information in the attached submission.
3. Failure to follow the formatting requirements may result in the exclusion of a submission. All submissions for the record are final.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TDD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Note: All Committee advisories and news releases are available online at http://www.waysandmeans.house.gov.

Chairman BOUSTANY. Good morning. And I want to call this hearing to order.

You might remember this Subcommittee was formerly called the Select Revenue Measures Subcommittee. But, to reflect the central role of tax in the Ways and Means Committee agenda, Chairman Brady and the rest of the Members decided to change its name to the Subcommittee on Tax Policy to give it its rightful position among subcommittees.

I also want to acknowledge the fine work done by the two Chairmen before me, Mr. Reichert and Mr. Tiberi, in moving forward the agenda on tax reform. Thank you, gentlemen, for the fine work of leading the Subcommittee.

Today the Subcommittee on Tax Policy will examine the final recommendations recently issued by the OECD on their Base Erosion and Profit Shifting project.

The alarming increase in foreign acquisitions of U.S. companies over the past decade, and especially in the last year, have exposed the critical and urgent need for tax reform in America. At 39 percent, the United States now faces the highest Federal and State combined corporate rate in the developed world, which is rapidly draining America of its homegrown innovation and business, and forcing companies to relocate to countries with more business-friendly tax regimes.

Globalization of the business marketplace has created historic opportunities for growth that were previously impossible. U.S. tax policy must account for these changes in this rapidly complex changing environment. Just last week, Pfizer, an American company founded in 1849 in New York City, announced the largest foreign acquisition of an American company in history. That is not the first, nor will it be the last.

Foreign acquisition has been pushed over the line by our broken Tax Code—and the last time comprehensive tax reform took place in the United States was 1986. And since then, our international counterparts have capitalized on our lack of action, outpacing us to a debilitating degree in adopting tax reforms needed to attract capital investment.

As international tax regimes have evolved, multinational companies have also evolved to become increasingly savvy in minimizing their overall tax liability. International competition for business and a fiduciary duty to shareholders obligates companies to be proactive. The political and policy hurdles that have prevented tax reform efforts from moving forward seem to pale in comparison to
the problem America faces with the mass exodus of American companies through foreign acquisitions.

Since 2001, global economic instability, alongside the increasing mobility of capital and high-value profitable business activities, have served as natural and powerful motivators for international tax reform. The substantial migration of multinational companies to more favorable tax jurisdictions has placed front and center an acute international awareness that there are limits to the tax burdens countries can place on their resident companies before they must seek a more favorable tax environment elsewhere.

All the while, the United States has failed to keep with the pace. It is being left behind. Indeed, the need for tax revenue resulted in the push by OECD to launch the BEPS project.

The OECD BEPS project was intended to target limited, overly aggressive tax planning, and resulted in inappropriate tax avoidance. In fact, one key theme of the BEPS project was to eliminate cash boxes. In effect, shell companies with few employees or economic activities, and which are subject to no or low taxes. However, the project quickly expanded into a fundamental rewrite of global tax practices, including those of the United States, in a relatively opaque process outside the reach of U.S. political process.

The OECD's BEPS project recommendations are deeply troubling on a number of levels, not the least of which is the aggressive attempt to impose substantial tax policy changes on the international community under the guise of eliminating so-called harmful tax practices to ensure multinational companies pay their “fair share” of taxes owed in the jurisdictions in which they operate. This is a highly subjective standard set by the OECD that seems to unnecessarily target American companies, while also disregarding the detrimental impact these recommendations will have on U.S. companies that currently operate under the worldwide system of taxation observed in the United States.

The BEPS project may have been motivated by an underlying belief that creating a business-friendly tax regime to attract business investment to one’s country is itself an illegitimate and harmful practice that must be eliminated. But the BEPS project ended up making recommendations that will achieve the opposite result, by encouraging countries to create patent boxes, which will effectively force worldwide companies to shift their business operations out of the United States in the absence of change.

Moreover, the exposure of American companies’ highly sensitive information through the country-by-country reporting requirements within BEPS’ recommendations are not constrained by any rationale for the breadth of information required, and are also lacking appropriate protections for highly-sensitive information in this regard.

The BEPS project final recommendations issued this year, coupled with the present European Commission investigation into alleged receipt of illegal state aid by mostly American companies, exposed what appears to be an extremely disturbing and multifaceted attack specifically targeted at American companies.

Ladies and gentlemen, we are out of time. We have nearly three decades of inertia with regard to tax reform. This must be the Congress of action that takes the tough but necessary steps to reform our Tax Code for the sake of American families, American compa-
nies, and America’s stature as the world’s leader in fostering innovation and business growth.

And, with that, I will yield to my Ranking Member, Mr. Neal, for an opening statement.

Mr. NEAL. Thank you very much, Mr. Chairman. And congratulations on your new post. A reminder that I have now either been the Chairman or the Ranking Member with the three people sitting to my right. So I provide some institutional anchor to the conversation that we are about to have.

Our Tax Subcommittee has a long and rich bipartisan history of coming together to address some of the Nation’s biggest problems. We have worked together in the past, and I hope to continue to work together on tackling very important issues of this day. Thank you for calling this important hearing on OECD’s Base Erosion and Profit Shifting project. The timing could not be more fitting.

A new wave of inversions has gripped the corporate world, as yet another U.S. multinational has renounced their U.S. corporate citizenship. In a record-setting $160 billion deal, Pfizer and Allergan— and a reminder, Allergan was also formerly an American company—have agreed to merge and create the world’s largest pharmaceutical company. With this merger, the U.S. tax base continues to erode. Perhaps this latest inversion will prompt Congress to come together on reforms so this does not continue to happen.

These inversions happen because of a broken Tax Code which allows these deals to take place. Congress must take action immediately, as we did in 2004, with legislation that I sponsored, to stop the flow of inversions until we can meaningfully fix our broken Tax Code.

Our rudimentary Tax Code remains ill-equipped to handle our increasingly globalized and digital economy. As a result, we have seen an explosion of multinational companies shift profits, activities, and property from high tax countries to low tax countries. By OECD’s best guess, countries are losing as much as $240 billion a year in lost revenue.

I want to commend the Obama Administration and Secretary Lew for their efforts in working with the international community and finding commonsense solutions to address these taxation challenges. I look forward to the hearing, the testimony from our distinguished panelists on the best ways to address the challenges ahead of us, and to ensure that the OECD process is not one where our jurisdictions try to grab revenue that rightly belongs to the United States.

But ultimately, the task of fixing our Tax Code falls on us, specifically on this Subcommittee. Mr. Chairman, it is my hope that we can use this hearing as a springboard toward meaningful reform, one that broadens the base and lowers the rate in a revenue-neutral way, as the Obama Administration has proposed.

Thank you, Mr. Chairman.

Chairman BOUSTANY. I thank the gentleman. Today we will hear from two panels comprised of experts on international taxation. I am very excited to have these panelists, who are all well-known experts in this area.

Our first panel will be Robert Stack, Deputy Assistant Secretary for International Tax Affairs, U.S. Department of the Treasury.
Mr. Stack, thank you for being here today. We appreciate the fine work you have done over the years, and we look forward to hearing your testimony. Rest assured the Committee has received your written statement. It will be made part of the formal hearing record. We ask you to keep to 5 minutes on your oral remarks, and you may begin when you are ready.

STATEMENT OF ROBERT B. STACK, DEPUTY ASSISTANT SECRETARY FOR INTERNATIONAL TAX AFFAIRS, U.S. DEPARTMENT OF THE TREASURY

Mr. STACK. Chairman Boustany, Ranking Member Neal, and distinguished Members of the Subcommittee, I appreciate the opportunity to appear today to discuss some key international tax issues, including the recently-completed G20 OECD Base Erosion and Profit Shifting—or BEPS—project. We appreciate the Committee’s interest in these important issues.

In June 2012, the G20 Summit in Los Cabos, Mexico, the leaders of the world’s largest economies identified the ability of multinational companies to reduce their tax bills by shifting income into low and no-tax jurisdictions as a significant global concern. They instructed their governments to develop an action plan to address these issues, which was endorsed by the G20 leaders in St. Petersburg in September 2013. The project came to fruition with the submission of the final reports to the G20 this fall.

The BEPS reports cover 15 separate topics. Some reports, such as those on the digital economy and controlled foreign corporation rules, are more or less descriptive of the underlying issues, and discuss approaches or options that different countries might take, without demonstrating any particular agreement among participants on a particular path. Other reports, such as those on interest deductibility and hybrid securities, describe the elements of a common approach that countries might take with respect to those issues. With respect to transfer pricing, the arm’s length standard was further amplified in connection with issues around funding, risk, hard-to-value intangibles.

And finally, in the areas of preventing treaty shopping, requiring country-by-country reporting, fighting harmful tax practices, including through the exchange of cross-border rulings, and improving dispute resolution, countries did agree to a minimum standard.

I believe that the transparency provided by country-by-country reporting, the tightened transfer pricing rules, and the agreement to exchange cross-border tax rulings will go a long way to curtail the phenomenon of stateless income. Companies will very likely be reluctant to show on their country-by-country reports substantial amounts of income or lower—in low or no-tax jurisdictions. And the transfer pricing work will better align profits with the functions, assets, and risks that create that profit.

The exchange of rulings will drive out bad practices and shine sunlight on the practices that remain. The improvement of dispute resolution and the inclusion, where possible, of arbitration, will streamline dispute resolution and should thereby reduce instances of double taxation.

Throughout this work, the U.S. Treasury Department worked closely with stakeholders—in particular, the U.S. business commu-
nity, which stands to be most directly affected by this work. And this was particularly the case in fashioning the rules on country-by-country reporting. Across the board, the BEPS deliverables are better than they would have been if the U.S. Treasury Department had not been heavily involved in their negotiation. We are proud of the role we played in the BEPS process, but our work is not done.

Where do we go from here? Well, certain technical work remains for the OECD in 2016 and beyond. And the participants in the G20 OECD project will be turning its attention to implementation of the BEPS deliverables, as well as monitoring what countries actually do with respect to those deliverables.

But we must do more than that. The G20 OECD project has produced well over 1,000 pages of material, some of it quite technical in detail. It is imperative that we turn our attention to ensuring that countries are able to implement these rules in a fair and impartial manner, based on the rule of law. What good is having carefully crafted new transfer pricing rules, if the agent in another country auditing a U.S. multinational is compensated based on the size of the assessment he or she can make against the multinational, regardless of its technical merit?

Can these rules really be fairly implemented if there is not access to a meaningful appeals process? Ensuring the fair and effective administration of the BEPS deliverables must be part of our ongoing work. Indeed, the best way to foster the G20 goal of supporting global growth is to actively promote the connection between foreign direct investment growth and efficient and effective tax administrations.

Foreign leaders often come to the United States seeking greater foreign direct investment in their countries from our investors, seemingly unaware of the impediment to such investment resulting from their very own tax administrations. We need to do a better job of making the connection between fair and efficient administration, foreign direct investment, and global growth. We are working hard to ensure that issues around effective and fair tax administration are made part of the post-BEPS agenda.

I would like to close by noting that it is no secret that the BEPS project was inspired to no small degree by the fact that large U.S. multinationals have been able to keep large amounts of money offshore in low-tax jurisdictions untaxed until those amounts are repatriated to the United States. This phenomenon, and the sometimes very resulting low effective rates of tax, in turn have led to the perception abroad that U.S. multinationals are not paying their so-called fair share.

Thus, the BEPS phenomenon also lends support to the need for business tax reform. The President’s proposal to lower corporate rates and broaden the base enjoys bipartisan support. We look forward to continuing to work with Congress to bring business tax reform to fruition.

Let me repeat my appreciation for the Committee’s interest in these important issues. And I would be happy to answer any questions you may have. Thank you.

[The prepared statement of Mr. Stack follows:]
Chairman Boustany, Ranking Member Neal, and distinguished members of the Subcommittee, I appreciate the opportunity to appear today to discuss some key international tax issues, including the recently completed G20/Organization for Economic Cooperation and Development (OECD) Base Erosion and Profit Shifting (BEPS) project. We appreciate the Subcommittee’s interest in these important issues.

I would like to begin by describing the outcome of the G20/OECD BEPS project, and then describe the expected BEPS follow-on work. I will then link that discussion to a consideration of the need for general corporate and international tax reform, as well as the related need to address U.S.-base stripping and inversion transactions.

G20/OECD Base Erosion and Profit Shifting (BEPS) Project

In June 2012, at the G-20 Summit in Los Cabos, Mexico, the leaders of the world’s largest economies identified the ability of multinational companies to reduce their tax bills by shifting income into low- and no-tax jurisdictions as a significant global concern. They instructed their governments to develop an action plan to address these issues, which was endorsed by G-20 leaders in September 2013 in St. Petersburg. The OECD has hosted this process, but all G-20 governments, some of which are not members of the OECD, had a role. The G20/OECD BEPS Action Plan outlined 15 specific areas for further examination. The results were delivered to Finance Ministers this October in Lima, Peru, and to President Obama and other world leaders at last month’s G20 summit in Antalya, Turkey.

The United States has a great deal at stake in the BEPS project and a strong interest in its success. Our active participation is crucial to protecting our own tax base from erosion by multinational companies, much of which occurs as a result of exploiting tax regime differences. A key goal of BEPS is to identify those differences and write rules that close loopholes. In addition, as the home of some of the world’s most successful and vibrant multinational firms, we have a stake in ensuring that companies and countries face tax rules that are clear and administrable and that companies can avoid unrelied double taxation, as well as expensive tax disputes. Both the United States and our companies have a strong interest in access to robust dispute resolution mechanisms around the world. In contrast, failure in the BEPS project could well result in countries taking unilateral, inconsistent actions, thereby increasing double taxation, the cost to the U.S. Treasury of granting foreign tax credits, and the number and scale of tax disputes. Indeed, notwithstanding the BEPS project, some countries have taken unilateral action, and it is our hope that they will reconsider those actions in the post-BEPS environment.

The principal target of the BEPS project was so-called “stateless income,” basically very low- or non-taxed income within a multinational group. The existence of large amounts of stateless
income in a time of global austerity has called into question the efficacy of longstanding international tax rules. This issue is prominent in a global economic environment in which superior returns can accrue to intangibles that are easily located anywhere in the world and that often result from intensive research and development activities that a single multinational may conduct in many countries, or that result from marketing intangibles that can be exploited in one country but owned and financed from another country. Some countries with large markets believe that some of these premium profits should be taxed in the market country, whereas current international norms attribute those profits to the places where the functions, assets, and risks of the multinational firm are located—which are often not the market countries. Finally, I would be remiss to not note that the ability of U.S. multinationals to defer tax on large amounts of income in low- and no-tax jurisdictions has fed the perception of tax avoidance by these multinationals. This perception exists even though the U.S. would tax that income upon repatriation to the U.S. parent firm—whether voluntarily by the taxpayer, or through a deemed repatriation that might occur as a part of tax reform.

The G20/OECD project produced a broad array of reports outlining measures addressing stateless income ranging from revision of existing standards to new minimum standards, as well as describing common approaches, all of which are expected to facilitate the convergence of national practices. All OECD and G20 countries have committed to minimum standards in the areas of preventing treaty shopping, requiring country-by-country reporting, fighting harmful tax practices, and improving dispute resolution. In transfer pricing, existing standards have been updated. With respect to recommendations on hybrid mismatch arrangements and best practices on interest deductibility, countries have agreed on a general tax policy direction. In these areas, we expect that practices will converge over time through the implementation of the agreed common approaches. In the United States, most of the rules restricting the use of hybrid entities and hybrid securities and the rules limiting excessive interest deductibility would require Congressional action, and the Administration proposed new policies along these lines in the FY2016 Budget. Guidance based on best practices will also support countries in the areas of disclosure initiatives and controlled foreign company (CFC) legislation. Finally, participants agreed to draft a multilateral instrument that countries may use to implement the BEPS work on tax treaty issues.

I would like to highlight some of the more important outputs from the BEPS project. Interest expense deductions are a major contributor to the BEPS problem. The ability to achieve excessive interest deductions, including those that finance the production of exempt or deferred income, is best addressed in a coordinated manner. The BEPS project has agreed on a best practice approach, which recommends that countries provide two alternative caps on interest deductions from which companies can choose. The first cap is a fixed ratio, which is similar to the rules under current U.S. law and looks at the ratio of interest expense to earnings before interest, taxes, depreciation and amortization, also known as EBITDA. The BEPS 2015 Final Report recommends that countries adopt a fixed ratio for allowable interest deductions within a range of 10 percent to 30 percent of EBITDA (current U.S. law allows up to 50 percent). The report also recommends that countries adopt as an alternative cap a group ratio based on earnings. Under this cap, each entity in a multinational group could deduct interest up to its allocable portion of the group’s third party interest expense, which would be determined based on the entity’s proportionate share of the group’s worldwide earnings. This rule is based on the
premise that multinational groups should be able to deduct interest up to their group-wide third party interest expense. The combination of this rule with a low fixed ratio also would ensure that groups would not be able to use related party loans to deduct interest expenses well in excess of the group's third party interest expense. As discussed below, the President's FY2015 and FY2016 Budget have included a proposal that is in line with this recommendation.

The OECD has agreed on hybrid entity and hybrid security best practices that target a "deduction/no inclusion" situation (i.e., a tax deduction in one country without an income inclusion in the other country) and a double deduction situation (i.e., tax deductions taken in more than one jurisdiction for the same item). In the case of the "deduction/no inclusion" scenarios, these recommendations would require Congressional action, and are broadly consistent with rules proposed in the President's FY2015 and FY2016 Budget. The recommendations addressing double deductions are modeled after existing U.S. rules. Importantly, the OECD approach to this action item is to neutralize the mismatch in tax outcomes, but not otherwise interfere with the use of such arrangements so as to not adversely affect cross-border trade and investment.

An agreement on a minimum standard to secure progress on dispute resolution was reached to help ensure that cross-border tax disputes between countries over the application of tax treaties are resolved in a more effective and timely manner. The Forum on Tax Administration (FTA), including all OECD and G20 countries along with other interested countries and jurisdictions, will continue its efforts to improve mutual agreement procedures (MAP) through its recently established MAP Forum. This will require an assessment methodology to ensure the new standard for timely resolution of disputes is met. In parallel, a large group of countries is committed to move quickly towards mandatory binding arbitration. It is expected that rapid implementation of this commitment will be achieved through the inclusion of arbitration as an optional provision in the multilateral instrument that would implement the BEPS treaty-related measures.

Standardized country-by-country reporting and other documentation requirements will give tax administrations a global picture of where profits, tax, and economic activities of multinational enterprises are reported, and the ability to use this information to assess various tax compliance risks, so they can focus audit resources where they will be most effective. Multinational Enterprises (MNEs) will report their revenues, pre-tax profits, income tax paid and accrued, number of employees, stated capital, retained earnings, and tangible assets in each jurisdiction where they operate. The implementation package provides guidance to ensure that information is provided to the tax administration in a timely manner, that confidentiality is preserved, and that the information is used appropriately. The filing requirement will be on multinationals with annual consolidated group revenue equal to or exceeding EUR 750 million, meaning this regime applies only to the largest and most sophisticated entities.

The existing standards in the area of transfer pricing have been clarified and strengthened as part of the BEPS project. Because the transfer pricing work is based on the arm's length principle, it is consistent with U.S. transfer pricing regulations under section 482. A key element of the work relates to the arm's length return to so-called "cash boxes," which would be entitled to no more than a risk-free return if they are mere funders of activities performed by other group members. The work on cash boxes is one aspect of new approaches to risk, which generally provide that contractual allocations of risk are respected only when the party contractually
allocated risk has the capacity to control the risk and the financial capacity to bear it. The transfer pricing work also addresses specific issues relating to controlled transactions involving intangibles, including providing a special rule for hard-to-value intangibles akin to the U.S. "commensurate with income" standard.

Where do we go from here? Certain technical work remains for the OECD in 2016 and beyond. More importantly, however, we believe the best way to foster the G20 goal of supporting global growth is to actively promote the connection between foreign direct investment, growth, and efficient and effective tax administrations. Too often countries fail to recognize that strong civil institutions promote growth and investment. The OECD is expected to present to the G20 a framework for moving forward at the Finance Minister’s meeting to be held in China in February 2016. We are working hard to ensure that issues around effective and fair tax administration are made part of the post-BEPS agenda.

**International Tax Reform**

The G20/OECD BEPS project shined a spotlight on so-called stateless income, a phenomenon that is a byproduct of outdated tax rules. I would like to outline the steps the United States could take today to reform our own tax system to improve competitiveness, secure our tax base, and reduce incentives for profit shifting by U.S. firms.

As the President has proposed, we should reform our business tax system by reducing the corporate income tax rate and broadening the base. It is frequently noted that the United States has a high statutory corporate rate, but much lower effective tax rates. High statutory rates encourage multinational firms to find ways to shift profits, especially on intangible income, to other jurisdictions. So lowering our statutory rate while broadening the base could help reduce erosion of the U.S. base.

But it would only be a start, because even with lower rates U.S. multinationals would continue to aggressively seek ways to lower their tax bills by shifting income out of the United States since there will always be jurisdictions with lower tax rates. We can, however, take other steps.

First, the President’s framework for business tax reform proposes a minimum tax on foreign earnings that represent excess returns, which typically arise from intangible assets. This would reduce the benefit of income shifting and impose a brake on the international "race to the bottom" in corporate tax rates. Other recent tax reform plans have included similar proposals, which would improve on the current complex international tax rules by requiring that companies pay a minimum rate of tax (either to the United States or to a foreign jurisdiction) on all foreign excess returns.

Second, as part of tax reform, we should also take a close look at interest deductibility, noting that our thin capitalization rules are inadequate and that our system actually gives an advantage to foreign-owned multinationals. These foreign-owned multinationals can lend funds to their U.S. subsidiary to benefit from interest deductions against a 35 percent tax rate, while the related interest income is subject to significantly lower tax rates, or no tax at all, in the lending jurisdiction. It is especially disconcerting to observe that among the foreign multinationals that
most aggressively take advantage of this strategy are so-called “inverted” companies – that is, foreign-parented companies that were previously U.S.-parented. The Administration’s FY2016 Budget proposes to level the playing field by limiting the ability of U.S. subsidiaries of a foreign multinational to claim interest deductions in the United States that greatly exceed their proportionate share of the group’s global interest expense. Specifically, this proposal would limit a U.S. subsidiary’s interest expense deductions to the greater of 10 percent of the subsidiary’s EBITDA or the subsidiary’s proportionate share of worldwide third-party interest expense, determined based on the subsidiaries’ share of the multinational’s worldwide earnings.

A related Administration FY2016 Budget proposal would limit a U.S. multinational’s ability to claim a U.S. deduction for interest expense that is related to foreign subsidiary income. U.S. multinationals typically borrow in the United States to benefit from interest deductions against a 35 percent tax rate, but they then use the borrowed cash throughout the multinational group, financing operations that may not be subject to current U.S. tax. Indeed, we have recently seen examples of U.S. multinationals borrowing in the United States—rather than bringing back cash from offshore operations—to pay dividends to their shareholders. The proposal would align the treatment of interest expense deductions with the treatment of the income supported by the proceeds of the borrowing.

In addressing stripping of the U.S. base, it is also important to consider so-called “hybrid arrangements,” which allow U.S. subsidiaries of foreign multinationals to claim U.S. deductions with respect to payments to related foreign entities that do not result in a corresponding income item in the foreign jurisdiction. These arrangements produce stateless income and should be remedied. To neutralize these arrangements, the Administration’s FY2016 Budget proposes to deny deductions for interest and royalty payments made to related parties under certain circumstances involving hybrid arrangements. For example, the proposal would deny a U.S. deduction when a taxpayer makes an interest or royalty payment to a related person and there is no corresponding inclusion in the payee’s jurisdiction.

Additionally, shifting intangibles outside the United States is a key avenue through which U.S. base erosion occurs. The principal means of shifting intangible income is to undervalue intangible property transferred offshore or to take advantage of the uncertainty in the scope of our definition of intangibles. Once this intellectual property is located offshore, the income that it produces can accrue in low- or no-tax jurisdictions. The Administration’s FY2016 Budget contains a number of proposals that would discourage the corporate tax base erosion that occurs via intangibles transfers. In addition to our proposal to impose a minimum tax on excess returns, the FY2016 Budget would explicitly provide that the definition of intangible property includes items such as goodwill and going concern value and would also clarify the valuation rules to address taxpayer arguments that certain value may be transferred offshore without any U.S. tax charge. Another proposal would update subpart F to currently tax certain highly mobile income from digital goods and services.

Conclusion:

Chairman Boustany, Ranking Member Neal, and distinguished Members of the Subcommittee, let me conclude by thanking you for the opportunity to appear before the Subcommittee to
discuss the Administration’s work on various international tax matters. We appreciate the 
Subcommittee’s continuing interest in the BEPS Project, international tax reform, and other 
matters. On behalf of the Administration, that concludes my testimony, and I would be happy to 
answer any questions.
Chairman BOUSTANY. Thank you, Mr. Stack. I—clearly, this Committee now certainly has a sense of urgency about what is happening on the international front. And, as developments have occurred in a rapid pace, whether it is the creation of innovation boxes or patent boxes by European countries, or the completion of the OECD BEPS recommendations, we are falling behind. We need to pick up our pace. And that means we need to move forward with tax reform. We need a firm commitment that the Administration will work with us getting beyond where we are today, and really roll up the sleeves to try to move forward on this.

But one of the concerns that a number of us have had, as we have watched through the fall with the completion of these recommendations on the BEPS project, is that Treasury might be perceived as speaking or committing to legislative policy recommendations on behalf of Congress without full consultation with Congress.

BEPS implementation will focus on getting countries to make legislative changes, which will require congressional action in this country. And I just want you to outline for us, in signing off on BEPS, to what extent did Treasury and others in the Administration consult with Congress, or consider whether Congress would agree with any of the specific tax policy recommendations?

Mr. STACK. Thank you, Mr. Chairman. I can report very directly that the—if you go through the BEPS’ 15 action items, there are 2 in particular that absolutely would need congressional legislative action. One is the work on interest stripping, which is in the BEPS project. And there is a second piece on what we call hybrid securities. That is a situation in which you get a deduction, let’s say, in the United States because it is treated like interest, but when it is received in the other jurisdiction, they view it as a dividend and don’t tax it, so that creates stateless income.

We were very careful, Mr. Chairman, not to include those in the minimum standard agreed at the OECD, precisely because we, as the Administration, could not and would not commit the U.S. Congress. I think, if you work through the other items, if you think, for example, of treaty matters, where we might agree, as a matter of Treasury, to put something in our model, a treaty, of course, requires the advice and consent of the Senate. Fully mindful of that, all our obligations in the BEPS process take into account the legislative processes in the United States.

I mean I would just add for the record that there is nothing in the BEPS project that is a legally binding commitment on the part of the U.S. Government. And so, I think we tried very hard to respect the legislative role and the difference between the legislative and the executive in every aspect of our work.

Chairman BOUSTANY. Well, I appreciate that. And I think what we need to do now, going forward, is accelerate our level of communication on how we are going to move forward. Because other countries are taking steps, very aggressive steps, with some of the implementation of these recommendations. And if we fail to reform our Code appropriately, we will not lead this process, it will be led by others, and I don’t think the outcome is going to be as amenable to American companies as we would all hope.

I want to shift gears for a minute with one last question for you. I want to examine this EU state aid situation. EU state aid cases
seem to be another example of foreign governments targeting U.S.
firms to expand their tax bases. And we have seen the press re-
ports. I have actually had a conversation with folks at Apple who 
are very concerned about this. I believe you share my concern that 
these EU state aid cases will lead to retroactive foreign tax in-
creases on U.S. companies that could result in American taxpayers 
footing the bill through foreign tax credits, further eroding our 
base.

I am very concerned that the effects will go far beyond the EU’s 
initial cases—I mean we are in the early stages of this—and that 
these cases could have substantial and direct impact on our U.S. 
companies—and ultimately our U.S. taxpayers.

In light of the EU’s state aid cases, what is Treasury doing to 
protect the interests of the United States?

Mr. STACK. Thank you, Mr. Chairman. I would like to begin this 
discussion with a note of humility. I am a trained U.S. tax lawyer. 
I am not an European lawyer. I am not a competition lawyer in Eu-
rope, nor have we seen the final legal documents of all the various 
investigations that are ongoing.

In light of that, we were faced with a judgement, which is do we, 
as the Treasury Department, simply sit and let these cases kind of 
move forward and unfold with the possibility that I can talk— 
which I will talk more about—of the effect on U.S. bilateral rela-
tionships and/or the possibility of an ultimate foreign tax credit if, 
indeed, these taxes are determined to be creditable, which is an 
open question I need to put on the record.

Or we could speak now about the U.S. interest in these cases, 
even though the work is not finally done. So what Treasury has 
done is we have made it clear to the EU Commission directly that 
the United States has a stake in these cases.

The first—our first stake is as follows. The United States has in-
come tax treaties with the member states in the EU. We do not 
have an income tax treaty with the EU. And that is because in-
come tax in the EU is left to the members to do their own income 
tax. Well, there is a great deal of uncertainty in the current pro-
ceedings whether or not the commission is substituting its own tax 
determination for that of the member states. And if it were to do 
that, I think it calls into question our bilateral relationships with 
members of the EU. And it is worth mentioning that the United 
States has an interest in understanding, with clarity, the precise 
nature of income tax enforcement administration in the EU. That 
is number one.

Number two, some of the numbers that have been reported in 
the press here are what I would call eye-popping. And while it is 
true—and I will repeat for the record that we have not analyzed 
whether or not taxes required to be paid in these jurisdictions will, 
in fact, be creditable. The fact that they may be could mean that, 
at the end of the day, U.S. taxpayers wind up footing the bill for 
these charges by the EU State Aid Commission.

But let me make two other points that I think are very impor-
tant here.

One is that I believe we also have a concern that these taxes are 
being imposed retroactively under circumstances in which—I do 
not believe countries, companies, tax advisors, or auditors ever ex-
ected a state aid analysis of the type that is emerging from this work. In our view, when a novel approach to law is taken, that is precisely the situation in which a prospective remedy would be appropriate, to ensure that the behavior ceases without imposing very large tax impositions on a retroactive basis. So we have been very careful to note that we think the basic fairness calls for these to be retroactive.

Beyond being public about our concerns, and demonstrating the U.S. interest, and demonstrating our concern that fairness calls for a prospective approach, to be honest, it is not 100 percent clear what other tools are at our disposal, except to make our concerns known. And we have done that, and hopefully will continue to do that.

Chairman BOUSTANY. We look forward to exploring options with you on that. You put your finger exactly on the real concern that I and other Members of the Committee have, about the retroactive nature of this, and how it is really, in effect, going after advance pricing agreements that are in existence. And this is deeply problematic.

I do believe we are going to need policy ideas that can be discussed between the Administration and this Committee on outlining our way forward on that. I thank you.

I now yield to Mr. Neal for questioning.

Mr. NEAL. Thank you, Mr. Chairman. I think on that question and the answer that was given by Mr. Stack there would be broad agreement on this Subcommittee and the full Committee. I don't know that there was anything that the witness said that we could disagree with on that. I thought it was right on target. So thank you for establishing that.

Mr. Stack, it appears clear that the Pfizer Allergan merger is moving forward, and the resulting inversion of one of the largest U.S. pharmaceutical companies is imminent. You and the witnesses on the next panel have testified on the need for tax reform, and specifically international tax reform, as an important and even vital step to ensuring that multinational companies remain competitive globally, and continue to create jobs and income in the United States. I think you would agree so far that such tax reform has been elusive, despite years of conversation on the Committee.

Are there some things that Congress could do right now, as we continue our efforts, to reform the Tax Code that could stem the tide of inversions?

Mr. STACK. Thank you, Congressman. Yes, I actually believe there are. And tomorrow I believe that if Congress were to lower the threshold for an inversion that forces the inverted company to retain its U.S. tax domicile from, let's say, 80 percent of the current statute to 50 percent, I believe that this would act very strongly to stem the tide of inversions because companies are quite reluctant to, let's say, give up control entirely, even in the public context, through a merger with another entity.

Second, I think that plugging our interest-stripping rules, so that once a company is inverted it is not able to take excess amounts of income out of the United States in the form of interest, is an imperative that we could do today, both to stem the tide of inversions, and also to level the playing field between foreign and domestic
As Secretary Lew has said, we have tried to do with our regulatory authority what we can. But these are some actions Congress could take that would help greatly, I believe, stem the flow of inversions.

Mr. NEAL. Mr. Stack, I have also heard from a number of multinational companies talk about the bad things that BEPS might do. I think everyone in the room would agree that it is certainly not in the United States’ best interest to do something like pulling back from BEPS in the project, or stand on the sidelines as the rest of the world implements BEPS rules that could greatly impact our multinational corporations. For the Members of this Committee, that could be tantamount, I think, to malpractice.

But to look at this from another angle, I think there are a number of very important things that the United States could specifically do, and that Members of Congress could join in in a helpful role.

There is an opportunity here, I think, for some very basic—many things that could be done on insight that other countries are now choosing to do. Their authority under the new rules is to ensure that the United States, after a period of time, would push the participating countries to ensure that their efforts are being monitored by their peers. Would you offer your insights on that, as well?

Mr. STACK. Certainly, Congressman. I think the—frankly, the next phase that we will be working very intensely on in BEPS goes to both the implementation—how will countries implement it. And here I mentioned I would like to push for the rule of law. And then, what kind of monitoring will we do? Will we watch other countries to see how they are implementing these rules?

From the U.S. perspective, there are a lot of areas where we are going to care a lot about the monitoring. We care a great deal about how country-by-country reporting is going to be done, whether it is confidential and whether it is used for the appropriate purposes. We are going to care a lot about whether new permanent establishment rules are applied in a fair and efficient manner.

So, some of the ongoing work in BEPS is going to be creating these monitoring tools, so that, over time, we are watching to see that countries are not simply using these new rules to grab revenue, but are applying them in a principled way. So that will absolutely be part of our ongoing work in BEPS.

And the country-by-country, I should add, in 2020 we actually all come back together to assess how the rules are working, how countries are doing them, are they producing necessary information for countries. And adjustments will be made, as necessary, at that time to the proposed rules, as well.

Mr. NEAL. Thank you, Mr. Stack. Thank you, Mr. Chairman.

Chairman BOUSTANY. Mr. Reichert.

Mr. REICHERT. Thank you, Mr. Chairman. And I want to take a moment, too, to thank you and Pat and the rest of our team over here, and then, of course, recognize Mr. Neal for his expertise and for being a good partner over the last year I was Chairman, and I thank the team on the Democrat side.
I am an old cop, a retired cop. So I am all about teamwork. And I understand that in this world sometimes politics get in the way of teamwork. But I think that you are hearing a lot of agreement so far with the testimony that you provided. And we will see how that goes as we continue to question you, but I appreciate all the work that you have done. And, as Chairman Boustany said, we really look forward to working with you to help make America stronger, and have that fair playing field that we all are searching for.

I want to focus on dispute resolution. You mentioned that in your testimony. Prior to the release of the BEPS final report, the number of tax disputes initiated between countries far outpaced the number of disputes actually resolved. And, as countries begin to implement the various changes to their own international tax rules, as recommended by the BEPS final report, the number of unresolved disputes is almost certain to increase. I think you would agree with that.

However, the final report did not call for mandatory binding arbitration. And as you mentioned in your testimony, the United States, along with 20 other countries, remain committed to pursuing mandatory binding arbitration procedures.

So, my question, Mr. Stack, is why was mandatory binding arbitration, which is, again, of great importance to American companies and the United States, in general, not included in the final report?

Mr. STACK. Thank you, Congressman. The short answer is the OECD BEPS project was a consensus kind of approach that sometimes played to the U.S. advantage, as we were trying to push items that we cared about. And in other circumstances, countries made clear that they were not yet ready to move forward on mandatory binding arbitration.

The reasons for that, by the way, are not always nefarious. I mean some countries don’t have experience with it. Some countries worry about whether or not they can keep up with wealthier countries that might be able to put a lot of resources into it. And many countries have a concern that it raises issues of sovereignty to give away the right to make their tax determinations. And, of course, I suspect some are concerned that they would come out on the losing end of many arbitrations if, in fact, their tax administration was put to the test.

The good news, however, Congressman, is the fact that—you referred to the fact that there are 20 countries ready to move forward in mandatory binding arbitration. This is something, when we were not successful in getting it in BEPS, we pushed it through the G7, and we have created quite a deal of momentum around it.

And I can also report that the 20 countries that are interested represent 90 percent of the dispute cases around the world. So, by bringing together a lot of the developed countries that actually have the cases today, we are able to put the real critical mass of countries into the pot of moving forward on mandatory binding arbitration, and we are deeply engaged in that work at the OECD and the multilateral.

The thinking I have is if we can get this critical mass of countries having experience with binding arbitration, that over time it
will grow out and attract the countries that for now are not willing to do that, most notably a country like India. And so we would try to demonstrate its success, make it part of the international tax fabric and, over time, I believe we will have success in making mandatory binding arbitration a standard tool in our international toolbox.

Mr. REICHERT. And I recognized at the end of your testimony you asked yourself the question where do we go from here, and you mentioned tech work, implementation, and large document—1,000 pages. Mr. Neal also asked about reporting and monitoring, which you mentioned, again, at the end of your comments. And you are looking for fair, efficient, and effective, all of those things you mentioned.

Where do we go from here when it comes to binding arbitration? Is it your testimony, then, that demonstrating success is a likely way to get countries to come on board with dispute resolution language?

Mr. STACK. Thank you, Congressman. I should have added that, as a very concrete next step, we are working in Paris on something called a multilateral instrument, which will try to put in one instrument the various treaty-related matters that have been agreed in the BEPS process. Mandatory binding arbitration will, we expect, be part of this multilateral instrument, at which point countries can sign up to the instrument and, in effect, put it into effect with those 20 countries, automatically if you will, subject, of course, to ratification by the Senate.

And so, that gives us a very concrete, near-term vehicle to move forward with mandatory binding arbitration. And then I think we would watch the results and try to build out from there.

Mr. REICHERT. Thank you. I yield back.

Chairman BOUSTANY. Mr. Larson.

Mr. LARSON. Thank you, Mr. Chairman, and congratulations to you. And kudos always to Mr. Neal and your other predecessors who served as Chairmen here, as well. And we want to get all these accolades out, and also condolences to Mr. Kelly on Notre Dame’s loss this past weekend. I was with you, I wanted you to know.

Thank you again for your testimony, Mr. Stack, and for your service to the Nation. And if I could, just a couple of followup questions, one on what Mr. Neal had to say, and the other one is—it relates to the BEPS process.

There is great concern about wholesale rewriting of the rules on the digital economy, with countries wanting the rights to tax companies with a so-called digital presence in their country. Did that occur? And can you discuss some of the Administration’s proposals regarding the digital economy and subpart F income?

Mr. STACK. Thank you, Congressman. Yes. I mean I think that, as I said in my opening statement, I think the U.S. presence in the BEPS project was critical to moving international rules to a better place for the United States.

As the—our digital companies are doing business all over the world. They are household names. They have penetrated markets and the consciousness of people and politicians all over the world.

And one of the issues we were facing in BEPS was whether or not there should be new rules to tax people who sell into an econo-
omy through the digital economy. And there is a great deal of fervor and political pressure to write such new rules. And I am proud to report that the digital report in the OECD was an excellent discussion of the technical tax elements of digital. But, at the end of the day, none of the more aggressive proposals for taxation based on a digital presence were adopted.

In the report there are options. And I believe also that European countries will turn, over time, more to that collection, which is totally appropriate. And I believe we were able to play a very constructive role in the digital space.

With respect to the U.S. issues on digital in our subpart F reforms, I would say that, quite different from the work in the OECD, whether we needed a brand new paradigm to tax the digital age, what we were really doing in the President’s budget proposals was really trying to conform our subpart F rules to the fact that we now have different modes of achieving, in the digital space, things that brick-and-mortar countries used to do.

So let me give you a very simple example of our rules. Our subpart F rules are based on a premise that, if you sell out of the United States, let’s say, to Bermuda, and then Bermuda on-sells, let’s say, into Europe, that the presence of this intermediate company provides an opportunity to do a little game-playing with how much income stays in the United States. And so, we have a rule called a foreign-based company rule, that says, well, if you’re going to buy from a related person and on-sell, we’re going to treat that Bermuda profit as really subpart F, and bring it back into the United States.

Well, in the digital space, if you think about it, you don’t need to buy and sell a widget. You might license some IP and then stamp a disk in Bermuda and sell it. And really, I think the easy way to understand our proposal is we simply brought our subpart F rules up to what we had been doing in the brick and mortar world, so that similar games could not be played by tech companies in the digital space. And we have a couple of examples like that in our budget.

Mr. LARSON. So let me quickly ask you, as well, you mentioned that there were—in addressing Mr. Neal’s concerns, there were two immediate things, one was lowering the threshold and the other was dealing with interest stripping.

You said going from 80 to 50 percent. Why 80 to 50? And, with interest stripping, could you give us a quick explanation of how that occurs?

Mr. STACK. Sure. Thank you. Well, in the interest stripping, you know, I often say when I speak, you know, you read a lot in the press about these highly-engineered structures to do base stripping around the world. And what I have said publicly sometimes, if you’re a foreign multinational you don’t really have to do something very fancy to strip out of the U.S. base, you just have to—maybe you even dividend up a note. You just hand something to your owner and say, “Now I owe you $1 million.” And those inter-
Our proposal—and one that we pushed at the OECD—said, “Wait a second. First of all, a multinational shouldn’t get, in our jurisdiction, any more than its pro rata share of its third-party borrowing.” And without getting too much into the weeds, what we did was we came up with a way to say you can get your share of global borrowing based on your EBITDA in the United States. And that seems fair. Or you can take a fixed percentage of your EBITDA so you don’t have to prove anything.

And in the Administration’s proposal we put it at 10 percent. The OECD work suggested a corridor of 10 to 30. But I would just point out for the Committee both of those are far removed from the 50 percent in our current 163J, which seem to permit far more interest stripping than we can probably afford, or that is based on sound tax policy.

Mr. LARSON. Thank you.

Chairman BOUSTANY. I thank the gentleman. Mr. Tiberi.

Mr. TIBERI. Thank you, Mr. Stack. I have a headache. This is just unbelievable.

[Laughter.]

So, in responding to Dr. Boustany’s question about the EU state aid cases, you said you are not sure what else Treasury can do besides express concerns.

Mr. Neal correctly identified the problem, and that is Congress not acting. But I would also argue, Mr. Neal, that there has been a lack of leadership at the White House on this very issue, as well.

To me, it is not very complicated. Number one, it is outrageous, what the EU is doing in retroactively targeting U.S. multinationals. I just think it is outrageous. But number two, to me, in my Fred Flintstone mind, it is not really complicated, what the problem is. We have a very uncompetitive Tax Code.

So, you can point to States. I was in Connecticut recently and I saw my friend, and the chatter there was about a large U.S. multinational company that has been headquartered there for a long, long time that was considering moving because of a new tax that was put in place in that State.

In my State of Ohio, we lost longtime multinational—and not even multinational—domestic companies not to just India, but to Indiana, to Georgia, to Texas. And the companies, many of them public, cited the Tax Code in Ohio. And this has happened internationally, as well. And yet we talk about trying to prevent ways by writing regulations and rules.

Mr. Stack, I don’t understand why we can’t look at this picture—I am cynically asking, I am not really asking you, because it is above your pay grade.

[Laughter.]

Why the Administration and Congress can’t come together and do what happens in communities in Ohio. One community loses a major employer to another community because the tax rate is lower in that community than the community they left. We see this all over. It is the marketplace.

And, at the end of the day, you write rules to try to stop this, and maybe we can—you know, we can hit that peg for a little
while, but it is going to come up somewhere else. And the reality is we have an uncompetitive tax system. And if we can lower the rate and go to a system, some exemption-type system, that puts our large employers who do business all over the world on the same playing field, quite frankly, that the rest of the world’s rules are on, then we could actually maybe see some of this loss of jobs and ultimate loss of revenue stop.

And for the life of me, I can’t understand, so I ask you this personally, not as a Member of the Administration, someone who leans to the left, rather than to the right. What is the problem with lowering rates and going to an exemption-type system that puts us—all our employers on a level playing field? Why not just do that?

Mr. STACK. Thank you, Congressman. First of all, I think you have just described the President’s plan.

Mr. TIBERI. Wow.

Mr. STACK. Because the President’s plan would lower the corporate rates, would broaden the base, and, in many of the jurisdictions around the world, where you pay more than a minimum tax, you are exactly on equal footing with your competitors in those jurisdictions.

Mr. TIBERI. Boy, oh boy. I remember watching the Democratic Convention and Joe Biden making fun of the exemption system, saying that would ship jobs overseas. So maybe the Vice President needs to get on board with the President, because I clearly don’t think that what I am describing is the President’s plan, because we would have passed that back in 2011. Or maybe you should have passed it back in 2009.

I mean, clearly, the market is doing something differently than what we would like it to do. And so, we have a—not a loss of jobs. We have a loss of really good companies. The only thing worse than an inversion is the company actually moving their headquarters overseas.

And I don’t know about the community you are from. The community that I am from, the jobs that—the employers that make up the heart and soul of the communities, whether they are small businesses, medium-sized businesses, or large businesses, are the ones that are headquartered there, because they are involved in the United Way, they are involved in the educational system. They provide so many dollars to the community. And we are losing those.

And, rather than trying to come up with these BEPS rules and anti-inversion rules, I just don’t understand and don’t see the leadership from the White House to say, “Look, let’s look at what other countries have done. Let’s look at what Ireland has done. Let’s look at what the UK has done. Let’s look at what other major employers, countries in the world have done, and follow their lead.” If we would have done that 3 years ago, we wouldn’t be having this hearing today. And maybe what we would actually be having is a great debate in Connecticut and in Massachusetts and Ohio and Louisiana about jobs coming here from Europe, rather than losing jobs to Europe.

I yield back.

Chairman BOUSTANY. I think the gentleman really outlined the problem beautifully. I thank him for that analysis.
Ms. Sanchez.

Ms. SANCHEZ. Thank you, Mr. Chairman. And I am prepared to yield more time to Mr. Tiberi, if he wants to unveil the Tiberi-Obama plan.

[Laughter.]

Mr. TIBERI. If you will support it, Ms. Sanchez.

Mr. THOMPSON. I ask unanimous consent that we do a letter asking the Vice President to support the Obama-Tiberi plan.

[Laughter.]

Ms. SANCHEZ. That is right, that is right. Reclaiming my time, Mr. Stack, thank you for being here today.

You mentioned that the United States had a presence in the BEPS discussion, and that was a favorable outcome, to have that input. You talked about making it known that we have a vested interest in what comes out of that project, and that you favor a prospective approach, and that there is this issue of retroactivity.

I am curious to know what other ways did your—did Treasury's participation in the BEPS project improve the outcome, the overall outcome, of the project?

Mr. STACK. Thank you, Congresswoman. In preparing for today I had occasion to go back through these BEPS action items and just think of the ways the United States demonstrated a very strong intellectual leadership in—actually, across the board of the actions. And let me just give you a couple of examples.

You know, transfer pricing is the prices that companies pay between affiliates across borders. Today, a lot of the action is around royalties and intellectual property, which is offshore. That constituted three action items: 8, 9, and 10. And there was an enormous push around the world to really water down the rules that respect contracts and respect the separateness of legal entities so that tax auditors and administrators could almost have carte blanche to look at a multinational setup and say, “Well, we think so much more profit should have been here than there.”

We were extraordinarily aggressive in the transfer pricing space, and I think we have produced a report—and I don’t think it is—I don’t think I need to be the test of it, but I think within the U.S. tax community people have seen that move back to something that is far more a recognition of the arm’s length standard and how to apply it.

On country-by-country reporting, I understand fully that it has been the subject of some complaint, because I can understand that any time you add burdens, et cetera, then there are concerns. But I have to say, on that one, the very first—first of all, the world started off wanting the multinationals to publicly produce their country-by-country data all over the world, number one. And number two, the first draft of that report didn’t just want 6 or 7 items per country. I believe the first draft wanted something in the neighborhood of 19 or 20 items. And there was going to be a—far more complexity.

And we worked with the business community, and we came back to OECD and said, “Look, this is what can be done in the least burdensome way. This is really all companies need.” And we were able to push the country-by-country stuff over the line.
In the hybrid work—and this is weedy, I will confess, and I won't get into the details—but there were times when the administrators around the world wanted U.S. multinationals to identify every single item on their books and records that might actually cause a mismatch. And we said, “Wait a second. This should be done among related parties,” because that is really where the problems are.

So, I think we went item after item, led very strongly, and have improved the quality of the work by our tenaciousness, our adherence to principle, and our technical skills.

Ms. SANCHEZ. I appreciate your answer. And I would just add one further thing before I yield back my time, that if Mr. Tiberi is interested in us, the United States, conforming our laws to that of most nations around the world, I would just point out that in the performance rights arena we lag far behind where the rest of the world is, and we give up revenue that sits overseas because we don't pay performance rights here in this country, as other countries do to our performers.

And, with that, I will yield back the balance of my time.

Chairman BOUSTANY. I thank the gentlelady. We will go next to Mr. Kelly.

Mr. KELLY. I thank the Chairman. Mr. Larson, thank you for your condolences, although I would just say to you that we both know Jerry Hogan. Jerry Hogan is the father of Kevin Hogan, the quarterback at Stanford. Jerry is a good friend of all of ours. His brother, Tom, and I went to school together at Notre Dame. And Jerry was also Notre Dame, too. But Kevin—I was happy—as much as I hate to see the Irish lose, I love seeing the Hogans win. So it is something about this Irish deal that keeps us together.

Mr. Stack, thanks so much for being here today. I am going to ask you a question, though. And I think Mr. Tiberi hit on it very clearly. Now, I come from the private sector. And in the private sector you are always looking for market opportunities. And in our case we are looking at a global market. And we are looking at competitors who look at us and say, “This is a country whose pocket we can pick,” because of tax policy and regulations that make it very hard for us to be competitive on a world stage.

Now, Senator Levin had proposed a bill in early 2014 that would place strict limits on mergers in which they move their tax address outside of the United States. Under the Senator's plan U.S. companies trying to buy a foreign company and relocate their headquarters to a lower tax country would have to ensure that shareholders of non-U.S. companies owned at least 50 percent of the combined company, up from 20 percent now. The bill would consider inverted companies to be domestic for U.S. tax purposes if executive control remained in the United States and if 25 percent of sales, employees, or assets remained in the United States. The measure would have been retroactive to May 2014, and would be in place 2 years while Congress considers broader tax changes.

Mr. Levin was responding to 14 companies that had conducted mergers since 2011 in which they moved their headquarters outside of the United States and into a lower tax jurisdiction. At the time of his announcement, Pfizer was contemplating such an inver-
esion. Fast forward to today. Pfizer has announced that is just what they are doing.

So, if you just did the Levin bill, that is a bill that actually became law, would that by itself forestall this migration of the U.S. tax base, considering the question within the context, relative of the tax advantage that foreign acquirers would gain from tighter inversion rules on U.S. companies?

Mr. STACK. Congressman, yes. I—we have a budget proposal that differs from the Levin proposal in some minor ways that I can’t recall as I speak at this moment. But the general concept of telling a company that if you are—if you retain more than 50 percent ownership by the U.S. shareholders of the formerly inverted company, you have it inverted and you are still United States, we think would help greatly stem the flow of inversions.

Mr. KELLY. Okay. But I think, when I heard Mr. Tiberi talk—and I think we all agree—in the private sector there is something about a carrot and a stick, and how you incentivize people to behave properly, or the way you would like to see them behave.

So, I don’t believe that a bigger stick that makes it harder for people to be profitable—and, by the way, we all want to see companies be profitable because they hire more people, they make more capital investments—I would rather see a carrot that makes sense in relation to what the rest of the world perceives as a global market, and as an advantage that they have, or in restructuring their Tax Code to say, “Come over here and shop with us, you can be here,” knowing that—I think this is the part that is really hard for people to sometimes grasp—the total cost of operation includes everything, not just your raw materials and your labor, but also tax policy.

When we artificially increase the cost of any product or service by a Tax Code or by regulation that makes it impossible to be on the same shelf globally as other countries, then it is time for us to take a look at what it is that we are doing wrong. Not what they are doing wrong. They are responding to an opportunity. It is not that they are not patriotic; they are just not stupid. Why the hell would you stay here, and continue to pay those kind of taxes and follow those kind of regulations, and then be held up as the worst people in the world because you are not paying your fair share? There is something that just doesn’t make sense about this whole piece.

And this is not a Democrat or Republican issue. This is an American issue. We continue to lose red-white-and-blue jobs. We continue to decimate our local economies. We continue to downgrade our ability to compete globally and then blame it on some kind of a corporate strategy. That is not the problem here. The problem is we have no strategy, going forward, to gain market share. And I am talking about global market share. If you really want to lift this economy, then do it the right way.

So I don’t expect you to respond to that, but, I mean, I don’t think the Levin bill does it. I would argue against any time that somehow a bigger stick, swung harder, is going to encourage people to stay. You know what they are going to do? They are going to say, “You know what? I am going to stay. I am not going to leave. But in the future, I am making investments someplace else, and
I will let this die on the vine. It can wither and go away. I will still succeed, but it won’t be here.”

And I think that is the real crux of the matter. We seem to think that somehow, by beating people, that we are going to make them perform better. That is not the key. The incentive is much, much brighter for America when we actually encourage people to make investments here, not tax them out of business or regulate them out of business and make them totally uncompetitive on a global stage.

Thank you, I yield back.

Chairman BOUSTANY. The Chair recognizes Mr. Thompson.

Mr. THOMPSON. Well, thank you, Mr. Chairman. And I also congratulate you on your rise to prominence in this fantastic Subcommittee.

Mr. Stack, thank you very much for being here. And it is interesting. We all seem to be coming from the same place on the dais, irrespective of the side. We may have a different way of articulating it, Mr. Kelly, but I think we all want to make sure that the United States is a competitive place where we attract businesses, businesses who will stay here, businesses who will come here, businesses that will create jobs, businesses that will pay a tax level that gives us the revenues that we need in order to fund the priorities that we have, as a Congress, as Americans.

And so, I guess my—what I am interested in is maybe some help from you, some guidance from you, as to how we get there. Your focus has been on business and international tax reform. The other side of the equation is the comprehensive tax reform that has had us all wrapped around our axles for the last many years. And is it your perception that we need to do one before the other?

You talked a little bit about some specific tax policy that could be done, irrespective of comprehensive, that would help things move along. But is it better to break it off and do the business international, or would doing comprehensive help you get to where you believe we need to be, in regard to the business and international?

Mr. STACK. Thank you, Congressman. I would mention, just as an opener, there has been, in terms of carrots and sticks and competitiveness—as a Tax Policy Committee, I think you folks know better than I do that, at the end of the day, the most competitive rate might be zero, but then we don’t raise any revenue.

So, as tax policy folks, we always are all thinking about what is the revenue we need to fund the government we have. And finding a happy median with that and these competitiveness concerns is kind of an obvious point. And so we are not free, I take it, to just join a race to the bottom to, let’s say, zero corporate tax rates without an alternative revenue source.

As to the second question, I would simply point out that the business tax reform in the last 2 years—there seems to have been some bipartisan consensus that a revenue-neutral business tax reform could be broken apart and done independently. And I think there has been a lot of good work done in lowering the rates and broadening the base and trying to get to the revenue-neutral business tax reform. Whether or not it is better to put it on with the comprehensive and the individual, I am simply going to report, as the
international guy on the team, I am afraid that falls a little above
my paygrade.

I don’t—I think there is a lot of complicated issues that folks—
that you all appreciate perhaps better than I do about the com-
plexity of going to the full comprehensive, you know, in the current
environment. And I think there was a judgement made at some
point to try to do the business-only on a revenue-neutral basis, and
that seemed to be, for a while, the most promising thing we could
do.

Mr. THOMPSON. Thank you. Before I yield back, I just want to
elaborate a little bit on the last point you made, and that is the
importance of being revenue-neutral. It has to be able to pay for
itself. And, if it doesn’t, all we are doing is digging the deficit hole
deeper, and passing on greater debt to future generations. I think
that is real important to keep in our focus, as we do any tax policy
in this House.

Thank you, and I yield back.

Chairman BOUSTANY. I thank the gentleman. Mr. Renacci.

Mr. RENACCI. Thank you, Mr. Chairman. And I want to thank
you for holding this hearing on this very important issue.

It is clear that our international tax system is outdated and anti-
competitive, and makes U.S. companies vulnerable to foreign take-
overs. In northeast Ohio we already have one large, multinational
that has inverted. We have another company that is considering in-
version. We have another one that looks like they are going to be
taken over. So these are issues that are very concerning to me.
And, Mr. Stack, you and I have talked about this in the past. So
I do think we have to continue to look at this and do what is nec-
essary to make sure that we are competitive here.

Mr. Stack, I am going to get into the weeds a little bit, though,
on one of the items finalized on round one. As you know, action 13
requires companies to maintain and report significant transfer pric-
ing documentation. Some have said that action 13 may be the most
important action item arising out of the BEPS project. I want to
focus on the difference between two of the types of documentations
that companies will be required to report, country-by-country, CBC,
reporting; and master file information.

Can you explain what types of documentation businesses must
provide under these two types of reporting?

Mr. STACK. Thank you, Congressman. The country-by-country
report is really a template in which a country would list the vari-
ous jurisdictions around the world in which it does business, and
then it would list out six or seven economic indicators: Its revenue,
its taxes paid, its taxes accrued, its assets, its retained earnings,
its number of employees. And then it would have a little code of,
like, what kind of a business does that company do. It is a dis-
tributor or a manufacturer.

So it is really a form, if you will, that sets forth that kind of in-
formation. The form will be filed with the U.S. tax return. And
then the U.S. Government will, with appropriate treaty or tax in-
formation exchange partners, exchange that form with jurisdictions
around the world that have promised to keep it confidential, and
use it for kind of a risk assessment.
The master file is really a different document. And, by the way, the work in this space about harmonizing transfer pricing documentation around the world precedent BEPS, because multinationals were basically stuck with a situation in which every country in which they did business was asking for a different kind of transfer pricing documentation to substantiate what it did.

So the OECD went to work and said, “Gee, we could have a win-win here. We can simplify this documentation to reduce the burdens on business and, at the same time, get the countries what they need.” And that aspect of it consists of two parts, really. There is something called the master file, which I will talk about, and then there is something called a local file.

And the local file is, oh, tell me about your foreign affiliates that have direct transactions with my country, so we can go in and check your transfer pricing. The master file is this overview document. Tell us about—in fact, I highlighted just a couple of sections of it—give us a high level—it is intended to provide a high-level overview in order to place the multinational group’s transfer pricing practices in their global economic, legal, financial, and tax context.

It is not intended to require exhaustive listings of minutiae, a listing of every patent, as this would be unnecessarily burdensome. Instead, it is an overview of the business, the nature of the operations, its transfer pricing policies, et cetera. And in producing that master file, which is written by the company, it should include lists of important agreements. But the company should use prudent business judgement in determining the appropriate level of detail.

So this is your big, overarching picture. It goes to the company. When they come in to audit you they know something about you and how you function. And that is the master file.

Mr. RENACCI. Mr. Stack, I am running out of time, but are you concerned that the master file information will be used by foreign governments to launch frivolous foreign audits or, even worse, leaked to foreign competitors?

Mr. STACK. I am—one can never say never, Congressman, right? However, we have to look at this context of the countries had the opportunity to ask for this on their own beforehand. We will be vigilant in watching how American companies are treated around the world, and we will try to take actions appropriately.

Mr. RENACCI. And I am going to move back to state aid, which I know the Chairman talked about.

It is disturbing to me that American companies are being targeted in proceedings and aren’t given an opportunity to defend themselves. My understanding is that only the countries can defend the state aid proceeding at the commission level. Companies that are subject to increased retroactive taxes—which we talked about, almost 10 years—are precluded from participating in the commission’s proceedings.

Mr. Stack, do you share the concern of fairness of these proceedings, if the company is not allowed to participate in these hearings?

Mr. STACK. Congressman, I am not an expert in the procedures in the state aid proceedings, so I am a little loathe to kind of judge them, you know, from afar. Obviously, opportunities like ability to
present your case are part and parcel of fairness, in our view. But I don’t know their procedures well enough to comment.

What I have chosen is the retroactivity aspect, because I think that stares us all in the face to say, “Hey, these are new rules, they should be applied prospectively, not retroactively,” and that is the piece that I have chosen to focus in on. And I apologize, I am not a procedural expert to know enough for the basis of your question. But, obviously, I am concerned about the fair treatment of our companies.

Mr. RENACCI. Thank you, Mr. Stack. I yield back.

Chairman BOUSTANY. I thank the gentleman.

Mrs. Noem.

Mrs. NOEM. Mr. Stack, thank you for being here today. I will keep mine short.

I am concerned that there isn’t mandatory binding arbitration procedures in the final report. When the United States, obviously, made it a priority, and several other companies—or countries, as well, asked for that, we look at the number of tax disputes every year—they far exceed those that are resolved. And as many countries start to implement some of the changes that were recommended in the final BEPS report, we are bound to see more tax disputes.

Why was there no binding arbitration procedures put in the final report?

Mr. STACK. Thank you, Congresswoman. I—we were also disappointed that we were not able to have mandatory binding arbitration as part of the final deliverables.

The nature of the BEPS process, however, was a consensus process. And so, countries were able, in effect, to veto the idea that we would have binding mandatory——

Mrs. NOEM. I understand that it was a major concern for many countries, up to 20 of the major countries that are part of the negotiations.

Mr. STACK. Yes, yes, it is. And the nature of the OECD process is it takes one country, basically, to block moving something forward.

Now, on the flip side of that is, when it came to the transfer pricing work, the United States was able to be very aggressive in saying, “We have certain demands before that work comes out.”

Mrs. NOEM. So what is our next process? What do we do about getting some procedures put in place?

Mr. STACK. We have 20 countries that have said, “We want to do mandatory binding.” And they represent 90 percent of the world’s disputes right now. And we are moving to put that in this multilateral instrument that, hopefully, that—part of which the United States can join, and hopefully get it signed and ratified by our Senate. And we will have made enormous progress, even though there will be some outlier countries, for the time being, that will not have mandatory binding arbitration with us.

So, it is not a whole loaf, but it is a pretty good loaf.

Mrs. NOEM. And the time frame on having those recommendations ready for the Senate’s consideration would be?
Mr. STACK. So the multilateral is hoping to finish a draft in 2016. I think that is very ambitious. So I think we are looking over the next couple of years when this would play out.

And, of course, we need to have those provisions look like provisions that we think our Senate would ratify. So there is a fair amount of work on that.

Mrs. NOEM. Okay, thank you. With that, I yield back.

Chairman BOUSTANY. I thank the gentlelady.

Mr. Holding.

Mr. HOLDING. Thank you, Mr. Chairman. I want to follow up on a couple of lines of inquiry from my colleagues.

First, from Mr. Tiberi—just to expand on his comments. You know, it is not only about rates. And if we could just simply lower the rates, broaden the base, you know, we would be much more competitive. It is also compliance cost. I had a series of interesting meetings with large multinationals, and just talked about how they comply with the U.S. Tax Code, and how they comply with other countries.

You take one particular company, tens of billions of dollars in revenue. Their U.S.-based operations, they have 40 IRS employees in their accounting division to continually prepare their returns, and so forth. In their UK-based operations with similar amounts of revenue, they are able to comply with the Tax Code there with no revenue agents in their accounting offices. It is a huge burden to comply with our Tax Code. So it is not only a matter of lowering the rates, Mr. Chairman, you know, it is a matter of simplifying the system so that companies can easily comply.

I want to follow up a little bit on Mr. Renacci’s comments about the master files. You know, it is—in the master files—I mean the information there is not general. There are a lot of specifics there regarding supply chains, service agreements, extremely sensitive information. Imagine the sensitivity of a defense contractor’s information who is doing work all around the world, in different countries, dozens upon dozens of different countries on every continent. You can imagine the angst they would have in supplying, you know, the information required by the master file.

So, I mean, I understand that Treasury will be compiling those, collecting and compiling those master files. Is that correct?

Mr. STACK. Congressman, we will—the IRS will collect the country-by-country file. The master file goes directly from companies to the countries in which they operate.

Mr. HOLDING. Okay. Will the Treasury also have the master files?

Mr. STACK. We—if—let’s say there is a U.S. company that operates in foreign jurisdictions. We would not necessarily get a master file from, let’s say, a U.S. resident multinational, because they are our taxpayer, they are here, and we have all the information we need about them.

Mr. HOLDING. So, I mean, if the master file is misused in some way, what recourse does a company have?

Mr. STACK. I think that one of the reasons I would like to move our focus—let me back up.

Companies already today deal with tax administrations that don’t always behave in the best ways, and they struggle with that.
And it is one of the reasons we want to move the BEPS work more into focusing on tax administration.

The second thing to keep in mind is companies—countries were always free to ask for a master file. What we really did at the OECD was homogenize the work so that there is, like, one file asked for around the world. We didn't really have a special power to tell countries what they could ask of multinational—

Mr. HOLDING. So in the BEPS process, was there consideration of some form of recourse that a company might have or, you know, special safe harbor provisions, where a company could shield sensitive information?

Mr. STACK. I——

Mr. HOLDING. Is there any arbiter of that——

Mr. STACK. On that last point, Congressman, we—the companies have the pen on that report, and we do not expect them to, willy nilly, give away sensitive information. Because we think the master file rules can be read in such a way that companies can use judgement to be sure the country gets the high-level view that I described without necessarily pouring out, you know, super-sensitive information. That was the judgement——

Mr. HOLDING. So, you know, during the BEPS process it was clear that the various countries involved were working hard to protect their own multinational countries, protect their own interests. So Treasury, at the table at the BEPS process, what were you doing to protect U.S. multinational countries during this process?

Mr. STACK. I think——

Mr. HOLDING. Give me your top three hits.

Mr. STACK. I think the top three hits are the work we did to make the transfer pricing respect the legal entities and contracts of our companies, I think the work we did to get the country-by-country reporting to be manageable for our multinationals, and I think the work we did to protect our digital companies from overreaching by foreign jurisdictions. Those are the three that I would say pop to mind——

Mr. HOLDING. Give me a couple where you think you failed.

Mr. STACK. I—we were disappointed that things like permanent establishment rules are looser than we would like, although there we said, “Well, we are not necessarily going to adopt those, but the rest of the world wants to.” And there we are going to come back on more work to make sure we can ring fence the work done on permanent establishment rules.

And the fact that countries around the world have opted for a kind of a very loose principal purpose test for treaty abuse was disappointing to us. Now, again, the United States is not going to adopt that approach, but other countries seemed to want to do that.

We wanted, in both those cases, more clear and administrable rules for other countries to follow, but other countries had different ideas.

Mr. HOLDING. Thank you. Thank you, Mr. Chairman.

Chairman BOUSTANY. I thank the gentleman. And I think Mr. Holding hit on some very important questions, given that we have 6103 protections for U.S. taxpayers and yet, under the master file,
we have serious concerns about those kinds of protections, going forward.

Mr. Stack, thank you for being here today. We appreciate your testimony. It has been extraordinarily—oh, I am sorry.

Mr. Reed.

Mr. REED. I know I am from New York, so we are often forgotten here. But if we could have the last word, Mr. Chairman, I would appreciate it.

Chairman BOUSTANY. You got it.

Mr. REED. Thank you, Mr. Stack. I do want to zero in a little bit on this master file issue, because it is of a concern to me.

So what I am hearing from your testimony is, essentially—and from your written testimony—is the Treasury is going to require country-by-country reporting mechanisms for certain companies—I think it is $800 million or more, or above. But with the master file, Treasury is not requiring that information.

And essentially, what I heard from your testimony—and is this accurate—that you are essentially saying companies are in the best position to protect their information, therefore we are going to let them make the determination as to what information they release in that master file? Is that the testimony you are offering?

Mr. STACK. Yes, Congressman.

Mr. REED. Okay. So what is Treasury going to do if someone challenges that determination by the businesses, that maybe they erred in their judgement, and a taxing administration says, “We need more information”? What is Treasury’s position or response to those multinational companies that are in that situation?

Mr. STACK. So those questions—that question could go in two directions. The first direction could be that a U.S.—a foreign country is always asking our multinationals for more information. It is a constant part of being a multinational tax director. And then you have the laws of the local country, and you—that local subsidiary may or may not have that information. And that is kind of a common, everyday dispute in the multinational space. So, in this case, that would be no different.

A trickier question could be, well, let’s say they don’t like the level of detail in the master file. And so they——

Mr. REED. That is my question.

Mr. STACK. Yes, and they impose a penalty, or they do something——

Mr. REED. Correct.

Mr. STACK. Then I do think—but I don’t think this is different in kind from a whole slew of administrative things we have to be paying more attention to, to protect our multinationals that I would like to get on the next wave of the agenda, which is: How do tax administrations act; do they act in good faith, in accordance with what the general consensus——

Mr. REED. You are going away from my question here, Mr. Stack.

Mr. STACK. Yes?

Mr. REED. Because, if I am understanding correctly, country-by-country reporting is going to be given to you, the Treasury——

Mr. STACK. Yes, right.
Mr. REED. And then that is going to be protected by tax information—
Mr. STACK. Yes.
Mr. REED [continuing]. Treaty agreements, and you will have the ability to defend what information is released, et cetera, and stand by those companies that are targeted maybe in an inappropriate manner.

But with the master file data, I don’t see the same type of protection that Treasury is offering to companies that, you know, make that error in judgement or say, you know, “We gave you enough information,” and the tax administration says, “No, we are going to hit you with a penalty.”

Treasury is essentially telling our guys, “You are on your own,” is what I am hearing from your testimony.

Mr. STACK. Well, the report does call for countries to treat it confidentially. But what I want to emphasize here is—and this is difficult——

Mr. REED. How are they going to treat it confidentially?

Mr. STACK. Because, in many of these jurisdictions, it is expected to be treated as tax return information in those jurisdictions. So it would just be——

Mr. REED. So your understanding is that the foreign countries are going to protect that information. And what is the penalty if the foreign country violates that——

Mr. STACK. We don’t have a specific penalty, Congressman. I mean, and that is fair. I think——

Mr. REED. That is the problem.

Mr. STACK. It is——

Mr. REED. That is the problem.

Mr. STACK. It is, Congressman, except if we never had a BEPS project, those countries could ask for the same information. We didn’t do anything special in the BEPS project that the country couldn’t have done on its own. What we did do was try to get a homogenized look at these——

Mr. REED. All right, so——

Mr. STACK [continuing]. Across the countries.

Mr. REED. Going into the negotiation, you recognized that the countries had the ability to potentially——

Mr. STACK. Yes.

Mr. STACK [continuing]. Abuse or inappropriately use that information, but we elected—you elected not to take that issue up. You elected to negotiate other points is what I am hearing.

Mr. STACK. No. Actually, Congressman, I think my big, heavy lift in the next part of BEPS is I want to get all the tax administration issues like this on the table, and get the world to agree to peer reviews and standards for what a fair and just tax administration should look like. And when we do that, that country could not assert a penalty on a master file, just because it is missing some jot or tittle, because that is not the spirit of that work.

That is a reason to stay engaged multinationally, but it is more work to be done for—to be sure, and it is a heavy lift. I wouldn’t doubt that. But it is important.

Mr. REED. So that is for future consideration and future——

Mr. STACK. Yes.
Mr. REED [continuing]. Negotiation. Because——
Mr. STACK. And it is important.
Mr. REED. Because that is another question I have. One of the things I am seeing here, potentially, on the international scene, especially with the EU, is the EU seems to be targeting, for lack of a better term, this revenue. And as they face austerity budgets in the EU, I just see, in my opinion, an aggressive attack by the EU to go after this revenue.

And you just said there is a future BEPS environment that you envision. What is post-BEPS? Where are you going? What is after? What can we expect in those negotiations, going forward, especially when the EU seems to be taking a very aggressive approach here?

Mr. STACK. Yes. I think I just want to—because they are doing it through their competition committee, they don't necessarily participate in the overall tax work that we do at the OECD, and that is part of the problem, I think, that you are pointing to.

Mr. REED. Yes.

Mr. STACK. In the—coming back to the tax world that I live in, I think the next phase in BEPS is how do we implement this, how do we monitor each other, how are we implementing it. And something the United States is aggressively trying to put on the table is how do we make everybody else behave with all this information. And that is something that I want to get companies and countries to focus on, both through the G20 and also at the OECD.

Mr. REED. I appreciate it. I notice my time has expired. With that, I yield back. I appreciate the information.

Chairman BOUSTANY. I thank the gentleman.

Well, thank you, Mr. Stack, for appearing before this Subcommittee. You helped walk us through some very difficult and complicated issues. Obviously, a lot more is going to be done in this area. I want to assure you that both sides of the aisle of this Subcommittee have a deep interest in how this is going to be implemented, and there are a number of outstanding questions. So, again, thank you, and we look forward to staying in touch.

We will now call the second panel up.

[Pause.]
We will now hear from our second panel of witnesses. We have a very distinguished panel, starting with Barbara Angus, Principal with Ernst & Young, followed by Gary Sprague, Counsel, The Software Coalition. Then Catherine Schultz, Vice President for Tax Policy, National Foreign Trade Council and Martin Sullivan, Chief Economist, Tax Analysts.

The Committee, as I stated earlier, has received your written statements. They will be made part of the formal record. We look forward to hearing your oral remarks, and I would ask each of you to limit those oral remarks to 5 minutes.

Ms. Angus, you may begin when you are ready.

STATEMENT OF BARBARA M. ANGUS,
PRINCIPAL, ERNST & YOUNG

Ms. ANGUS, Chairman Boustany, Ranking Member Neal, and distinguished Members of the Subcommittee, it is an honor to appear before you. My name is Barbara Angus, and I am leader of strategic international tax policy services for Ernst & Young. Ear-
lier I had the privilege of serving as international tax counsel for the Treasury Department, and as business tax counsel for the Joint Committee on Taxation. I am appearing today on my own behalf, and not on behalf of EY or any client.

I am pleased to be here to discuss the practical implications of the final reports issued by the OECD as part of its BEPS project. Other countries are already implementing aspects of the recommendations, so this hearing is very timely. As the Ways and Means Committee continues its work toward U.S. tax reform, it is important to consider the BEPS recommendations, the actions that other countries are taking in response, and how those actions will affect global companies that are headquartered or invested in the United States.

At the core of the reports issued by the OECD last month are recommendations for significant changes affecting fundamental elements of the international tax framework. Countries must now consider whether, how, and when to act with respect to the BEPS recommendations. They will act in their own interests and under their own timetables.

The OECD project arose out of a growing political and public focus in many countries on the taxation of foreign companies. Therefore, I have no doubt that significant action with respect to BEPS will take place across countries around the world. Indeed, countries had already begun taking unilateral action to address BEPS, even before the OECD issued its reports.

The international tax changes that are embodied in the BEPS recommendations have significant implications for all global businesses. While the OECD did not deliberately target U.S. companies, the recommendations could have a disproportionate impact on U.S. businesses because of their geographic spread and the particular pressures of the U.S. worldwide tax system. Moreover, some countries have singled out U.S. companies, and the recommendations could well be used by countries in such targeting.

Global companies face uncertainty in light of the BEPS recommendations, significant uncertainty. The BEPS recommendations generally reflect a move away from relatively clear rules and well-understood standards to less-specific rules, more subjective tests, and vaguer concepts. Global companies face significant new compliance burdens highlighted by the new country-by-country reporting requirement.

Global companies face significant risk of misuse of their business information. The new reporting would put global information about a company into the hands of all countries where it operates. For U.S. companies, which tend to have the broadest global footprint, the risk of breaches of confidentiality is particularly acute.

In this regard, many U.S. companies believe it is in their interests for the United States to implement the recommended country-by-country reporting so that they can provide their information to the IRS to be shared under U.S. information exchange relationships, subject to the U.S. rules on confidentiality of taxpayer information. This approach would mean greater protection and lower administrative burdens than the alternative, of U.S. companies directly providing their information to multiple foreign countries.
Global companies face significant risk of controversy. The new rules are subject to varied interpretation. Controversy imposes substantial resource burdens on both taxpayers and tax authorities. For taxpayers, controversy in a foreign country is even more complex.

Global companies face significant risk of double taxation. Where countries do not apply the new transfer pricing guidelines included in the BEPS recommendations in the same way, for example, multiple countries may assert taxing jurisdiction over the same dollar of income. One of the BEPS focus areas was improving the dispute resolution mechanisms used to prevent this kind of double taxation. But the BEPS project made little progress in this area, which is a major disappointment for the U.S. business community.

Importantly, there is continuing work in the OECD on BEPS that provides opportunity to ameliorate these issues. Business input is much needed, and the U.S. business community, which has much at stake, should continue its participation in the OECD process. In order to ensure that U.S. interests are protected, it is essential that Treasury, in consultation with the tax rating committees, continues to play an active role in all aspects of the OECD/BEPS work.

Countries’ actions with respect to the BEPS recommendations will dramatically change the global tax landscape. The aspects of the current U.S. tax system that detract from the attractiveness of the United States as a location to headquarter and invest will become more acute as other countries implement the BEPS recommendations. The BEPS project, and the response by foreign countries, should be viewed as yet another reason why tax reform must be an urgent priority.

Thank you for the opportunity to present these views.

I would be happy to answer any questions.

[The prepared statement of Ms. Angus follows:]
Statement of Barbara M. Angus to the
House Committee on Ways and Means Subcommittee on Tax Policy
Hearing on the OECD Base Erosion and Profit Shifting Project

December 1, 2015

Chairman Boustany, Ranking Member Neal, and distinguished members of the Subcommittee, it is an honor to appear before you today as the Subcommittee considers the implications of the OECD Base Erosion and Profit Shifting (BEPS) project. I am leader of Strategic International Tax Policy Services for Ernst & Young LLP. Earlier in my career, I had the privilege of serving as International Tax Counsel for the U.S. Treasury Department and as Business Tax Counsel for the Joint Committee on Taxation. In my role at Treasury, I was the lead U.S. representative to the OECD Committee on Fiscal Affairs, which is the OECD group responsible for work related to taxation. I am appearing today on my own behalf and not on behalf of EY or any client. The views reflected in my testimony are my own.

With the OECD’s recent issuance of final reports in connection with its BEPS Action Plan, the BEPS project is entering a new phase where the focal point will be implementation of the recommendations reflected in those reports. At this stage attention must turn to the practical implications for global businesses of the changes in international tax laws and treaties that are embodied in the BEPS recommendations and that are being considered and adopted by countries around the world. Moreover, as the Ways and Means Committee continues its work toward reforming the U.S. tax system, it will be important to consider the principles and recommendations reflected in the final BEPS reports, the actions that other countries are taking in response to the BEPS recommendations, and how those actions will affect global companies that are headquartered or invested in the United States.

OECD BEPS Project, Final Reports, and Next Steps

On October 5th, the OECD issued final reports with respect to all fifteen focus areas in its BEPS Action Plan. The reports were endorsed by the G20 Finance Ministers at their meeting on October 8th and the G20 Leaders at their summit on November 15th-16th. At the core of the reports are recommendations for significant changes in countries’ tax laws and treaty provisions that affect fundamental elements of the international tax framework.

The OECD’s focus on BEPS began in 2012, and at the direction of the G20 BEPS became a formal project with the issuance of a preliminary report in February 2013 and the fifteen-point BEPS
Action Plan in July 2013. This occurred against the backdrop of increasingly intense criticism in Europe and elsewhere of the taxation of foreign companies with inbound investment, highly-charged rhetoric about “fair share” of taxes, and allegations of tax evasion fueling headlines in the press. The creation of an OECD project was viewed by policymakers in some G20 countries as a constructive way to approach the underlying concerns about the international tax system, through the OECD’s historic role as a forum that brings countries together to consider tax matters of common interest from a combination of technical, policy and economic perspectives. However, the ambitious scope and timetable established for the project necessarily challenged the deliberative process for which the OECD is known. Rather than narrowly targeting the potential for artificial shifting of income and other erosion of countries’ tax bases, the BEPS Action Plan involves virtually every aspect of the international tax infrastructure. The short deadlines included in the Action Plan meant that there was little time to engage fully with stakeholders or to reach solid agreement among countries grounded in mutual understanding of the final outcomes.

The OECD’s issuance of final BEPS reports was the culmination of an expedited process of discussion drafts, comment periods and consultation sessions with respect to each of the fifteen focus areas. The global business community, including many U.S.-based businesses that actively participated in the process, submitted thousands of pages of comments on the various discussion drafts, addressing policy, economic, technical and practical aspects of the proposals for change. Business representatives participated in consultations with OECD and G20 member country officials to present their perspectives and concerns and to respond to questions and requests for further input. Other interested parties, including representatives of non-governmental organizations, also provided input during the consultation process. At the same time, the dialogue among country officials regarding the development of the recommendations continued, as the discussion drafts that were released generally were preliminary in nature and did not yet reflect agreement among the participating countries.

The final reports that were issued represent an evolution, to a greater or lesser degree, from the original drafts. Several of the final reports reflect moderation, in some cases significant, of the initial proposals for change. U.S. Treasury was an important voice in the discussions that led to these refinements. However, the process revealed how much divergence of views there is among countries in many areas. Because the OECD operates by consensus, unanimous acceptance was required for the issuance of the reports. Given the wide range of views, reaching agreement required the inclusion of options and alternative approaches in some of the reports. In other cases, the use of fairly general concepts and broad language to leave room for varied interpretations likely facilitated acceptance of the final reports.
As the OECD acknowledges, countries are sovereign and the OECD is not a rule-making body. As part of the BEPS project, OECD and G20 member countries have agreed on the recommendations reflected in the final reports. However, given the options, alternatives and broad language reflected in the reports and the complexity inherent in meshing any of these concepts with countries' existing domestic tax systems, there may be significant distance between agreement in the OECD process and ultimate adoption of new domestic tax rules. Moreover, most of the recommendations likely would require legislative changes or treaty revisions, thus necessitating the legislative or treaty ratification processes which in many countries are separate from the process for participation in the OECD. In addition, some countries may already have measures in place that they believe are consistent with one or more of the BEPS recommendations such that they would take the view that no further action would be needed in those areas.

At the same time it issued the final reports, the OECD also issued an explanatory statement that describes additional work to be done in connection with the BEPS project. There will be follow-on work in several areas, including essential work to address industry-specific issues that were not resolved in the final reports and some broader work related to transfer pricing. This work is expected to be completed in 2016 and 2017. Negotiations have just begun on the so-called multilateral instrument that is envisioned by the OECD as a mechanism for amending existing bilateral tax treaties to incorporate the BEPS recommendations that are treaty-based without a separate bilateral negotiation for each such treaty. These negotiations are expected to be completed by the end of 2016, with the instrument then open for signature by interested countries subject to each country's applicable ratification procedure. The OECD plans to develop a peer review process with respect to countries' practices in resolving disputes under treaty-based mutual agreement procedures. It is expected that this will be based on a similar process in place for peer review of countries' exchange of information practices. At the direction of the G20, the OECD also intends to develop a framework for monitoring countries' implementation of the BEPS recommendations. While the form and nature of this monitoring is not yet defined, the G20 intends that additional countries should be involved in this aspect of the BEPS work going forward. Finally, the OECD statement indicates that the OECD and G20 will continue to work together on BEPS until 2020.

Country Activity with respect to BEPS

With the OECD's issuance of the final reports, countries must now consider whether, how and when to act with respect to the various BEPS recommendations. Countries will act in their own interests and according to their own timetables. Coordination and consistency of action are
likely to be limited as each country interprets the BEPS recommendations through its own lens and in the context of its own tax policies and practices.

Notwithstanding the likely absence of a coordinated approach, significant action with respect to BEPS nevertheless is expected across countries around the world. The OECD project arose out of a growing political and public focus in many countries on the taxation of foreign companies. More than 60 countries actively participated in the BEPS project, including all members of the OECD and G20 and a substantial number of developing countries. More than 90 countries are participating in the negotiation of the multilateral instrument to be used to amend existing bilateral treaties to incorporate the treaty-based BEPS recommendations. Thus, there is substantial interest by countries in the BEPS recommendations.

In the case of the BEPS recommendations with respect to transfer pricing, which represent some of the most significant changes coming out of the BEPS project, the new rules will have effect in some countries without further action by the country. The recommendations are reflected in revisions to the OECD transfer pricing guidelines, which in many countries, other than the United States, have been made a part of the countries’ rules on transfer pricing through legislation or guidance. Thus, in these countries, the transfer pricing changes will become applicable as soon as the revised guidelines are finalized by the OECD.

Countries had already begun taking unilateral action to address BEPS even while the OECD process was continuing and before final recommendations had been agreed. In some cases the action taken anticipated the final BEPS recommendation and is generally consistent with it. In other cases, unilateral action that is inconsistent with the BEPS recommendations has been taken. In addition, in many countries, tax authorities have been citing BEPS concerns as justification for new administrative practices even without any change in the applicable law. In addition to individual country action, the European Union already has agreed on measures to address BEPS that all EU member countries are required to implement and several additional BEPS-related measures are under ongoing discussion in the European Union.

EY has been tracking BEPS-related developments in countries’ tax law and administrative practices since the beginning of 2014. In the past two years, BEPS-related developments in more than 60 countries have been identified. Illustrations of the kinds of measures that already have been enacted, implemented or proposed include the following:

- The United Kingdom has enacted the diverted profits tax which would impose a penalty rate of tax in situations where it is considered that a permanent establishment has been avoided or profits otherwise have been artificially shifted out of the United Kingdom.
• Mexico, Poland and Spain have adopted country-by-country reporting requirements; legislation that includes country-by-country reporting is advancing through the process in Australia, China, Denmark, France, Ireland, the Netherlands, and the United Kingdom.
• The European Union has amended a directive to address certain hybrid arrangements which is to be implemented by all member states by the 2015. Brazil and Norway have proposals to address hybrids. France and Mexico have enacted anti-hybrid rules that go beyond the BEPS recommendation in this area.
• Australia, Austria, Brazil, Poland, the Slovak Republic, South Africa, and Spain have made changes to rules related to the deductibility of interest. Costa Rica, Indonesia, Japan, Korea, Lesotho, and Norway are considering changes in such rules.
• Argentina, Australia, Chile, and Germany have amended tax treaties to restrict access to benefits. Vietnam has issued administrative guidance limiting treaty benefits.
• The European Parliament is discussing requiring public reporting of information similar to the information required in the country-by-country report.

Implications for Global Businesses

Global businesses will need to monitor developments in all the countries where they operate or invest. Even in the absence of any immediate U.S. legislative action, U.S.-headquartered companies will be adversely affected by actions that are taken in the foreign countries that are part of their global footprint. The potential effects are an immediate concern because, as noted above, BEPS-related change has occurred in countries already and additional action is expected with countries’ year-end tax legislation.

The OECD BEPS project and the international tax changes that are embodied in the BEPS recommendations have significant implications for all global businesses. In today's global economy, a business need not be large to have international operations. While the OECD project did not deliberately target U.S.-based companies, the recommendations could have a disproportionate impact on such businesses as they tend to be the biggest companies with the broadest global footprint. In addition, the implications of the current U.S. worldwide tax system may have the effect of exacerbating the adverse impact of the BEPS recommendations for U.S.-based companies. Moreover, some countries certainly seem to have singled out U.S.-based companies in their criticism of foreign investors and the BEPS recommendations could well be used by countries in such targeting.

Global companies face significant uncertainty in light of the BEPS recommendations, uncertainty that can be a substantial barrier to cross-border operation and investment. Change of the magnitude contemplated in the BEPS recommendations necessarily creates uncertainty.
The options and alternatives reflected in the BEPS recommendations add to the uncertainty, as does the fact that each country will make its own choices with respect to the recommendations. But the most fundamental uncertainty comes from the form of the recommendations, which generally reflect a move away from relatively clear rules and well-understood standards to less-specific rules, more subjective tests and vaguer concepts. Many of the new rules will be more difficult both for taxpayers to apply and for tax authorities to administer. Interpretations of the new rules are likely to differ – across countries, between taxpayers and tax authorities, and even over time.

One illustration of the uncertainty inherent in the new rules is the recommendations with respect to the permanent establishment standard, which is the concept used in tax treaties to establish a threshold for taxable presence in a country. The BEPS recommendation on permanent establishment replaces what are relatively bright-line standards with vaguer and more subjective tests that clearly lower the threshold but are much less clear as to exactly where the new threshold lies. A global company would have to operate without clarity as to when its activities in a foreign country would be considered to give rise to a permanent establishment such that its operations in the country would be treated like a local taxable entity subject to all of the country’s domestic tax obligations. At the same time, the company’s home country may see the new rules differently and may not be prepared to cede taxing jurisdiction over those operations.

Global companies face significant new compliance burdens. This includes most directly the transparency-focused BEPS recommendations: the new requirement for country-by-country reporting, the two-tier approach to transfer pricing documentation, and the mandatory disclosure regime. However, the compliance obligations do not end with the filing requirements but also will include the follow up that will be required in many countries to explain the new reporting and to put the information in proper context.

As an illustration, the new country-by-country report requires global companies to provide country-based information on various measures of income, taxes, and economic activity for all countries where they have entities or branches; this information is to be delivered to the company’s home country tax authority to be shared with other countries under tax information exchange relationships or alternatively must be delivered to each country directly. The required information typically is not maintained by companies in this form for any other purpose so companies will need to create new systems and processes in order to collect the information. The report requires financial accounting information, not tax information, so it will not tie with local tax returns. The report requires information that is aggregated by country, without the elimination of intercompany transactions as is done in a financial consolidation, so
it will not tie to the consolidated financial statements. Global companies will have to be prepared to respond to inquiries and provide additional information (or deal with adjustments that are proposed on the basis of the report alone) in all the countries that receive the country-by-country report. In the case of U.S.-based companies, this could be as many as a hundred or more countries, including countries where the company has relatively little local presence.

New compliance burdens also are embedded in the substantive changes reflected in the BEPS recommendations. As noted above, a global company that is considered to have a permanent establishment in a country is subject to the country’s domestic tax obligations with respect to its local operations. With the BEPS recommendation lowering the permanent establishment threshold, global companies likely would have new permanent establishments, perhaps in multiple countries. This would require the establishment of new systems to create and maintain separate books and records for each set of activities that is found to be a permanent establishment. It would require the filing of income tax returns for the permanent establishment. Moreover, in many countries, the finding of a permanent establishment has consequences beyond income tax. A permanent establishment often will be required to register for and collect value added tax. Other business registration and license requirements also may be triggered.

Global companies face significant risk of misuse of core business information. The new transparency requirements would put information about a company’s entire global footprint into the hands of all the countries where the company has entities or branches. For U.S.-based companies, which tend to have the broadest global footprint, the risk is particularly acute. The information required to be provided would include commercial data that is competitively sensitive. For example, the country-by-country report includes revenue and profit information from which operating margins could be estimated. The information also could be used to cause reputational damage. The information in the country-by-country report is an annual snapshot, so it might show, for example, that a company pays little or no tax in a country despite having significant income in that country without showing that this result is because of substantial net operating losses carried over from prior years. A company with that profile could be falsely branded a tax evader based on information that is improperly released to the public (in such a case the tax authority also could be falsely criticized as having failed to enforce a tax obligation). Because all countries that receive a company’s country-by-country report will have its global information, a breach of confidentiality in any one country could have global effects.

Global companies face significant risk of controversy. The fundamental changes and new rules subject to varied interpretation that create uncertainty for global companies also create controversy with tax authorities. The BEPS recommendations largely are high-level policy
statements. Proper implementation will require detailed and specific guidance. In many cases, appropriate transition into the new rules will be needed. In all cases, training of the tax authority personnel responsible for administering the new rules will be essential. Controversy will arise when there are gaps in any of these areas. With change happening all around the world, global companies likely will be dealing with controversy in multiple foreign countries at the same time. While some countries have advance resolution mechanisms that are intended to head off controversy, like the compliance assurance program or CAP in the United States, the demand for these mechanisms may well exceed their capacity. Many countries have no procedures for addressing issues in advance. Moreover, in some countries taxpayers have no real access to a judicial system to resolve disputes. Controversy imposes a substantial resource burden on both taxpayers and tax authorities. For taxpayers, controversy in a foreign country is more complex and requires more resources. And controversy that cannot be properly resolved results in inappropriate taxation.

Consider the BEPS recommendation on limiting access to tax treaty benefits, which includes a proposed rule under which a taxpayer would be denied treaty benefits if one of the principal purposes of the transaction was to obtain treaty benefits, unless the taxpayer can establish that the granting of such benefits would be in accordance with the object and purpose of the treaty. A global company that loans funds to a foreign affiliate will receive interest payments from the affiliate. Countries typically impose a gross-basis withholding tax on cross-border interest payments (for example, the U.S. withholding tax rate is 30%), but provide an exemption from such tax under their tax treaties. If the company is challenged under the test described above, it is not clear what proof would be required by the foreign country to establish the company's entitlement to the benefits of the treaty. In the absence of treaty benefits, the tax imposed on the gross amount of the interest payment could exceed the company's net income from the lending activity once its cost of funds is taken into account.

Global companies face significant risk of double taxation. As noted above, the recommended rules are subject to varied interpretations. Some countries may choose to go beyond the final recommendations, including resurrecting approaches that were proposed by the OECD in initial discussion drafts but were replaced with more moderate approaches in the final reports. Other countries may adopt unilateral measures. Where two or more countries do not interpret or apply the new transfer pricing rules in the same way, for example, they may assert taxing jurisdiction over the same dollar of income. One of the BEPS focus areas was the dispute resolution mechanisms in tax treaties that are intended to prevent this kind of double taxation. However, while the OECD's aim was to develop approaches for improving the effectiveness of these dispute resolution mechanisms, relatively little was accomplished in this regard. It is the view of many business stakeholders and policymakers in many countries that mandatory
binding arbitration is an essential mechanism for ensuring the resolution of treaty disputes. Arbitration provisions have been included in U.S. tax treaties and are viewed as having a positive effect in terms of preventing disputes. However, some countries participating in the BEPS project have rejected such a mechanism. Where a treaty dispute cannot be properly resolved, the result for the company is unrelieved double taxation.

Even though the OECD has issued its final BEPS reports, the continuing work in the OECD on BEPS provides some opportunity to ameliorate these issues. The additional technical work that is planned should provide much needed guidance on industry-specific issues and could include further guidance on the interpretation and practical application of the BEPS recommendations more generally. The planned peer review process with respect to dispute resolution practices will allow continued attention to be focused on the need for improvements to all aspects of such practices and continued effort to expand the group of countries that are committed to mandatory binding arbitration. The framework to be developed for monitoring implementation of the BEPS recommendations should go beyond merely identifying which countries have taken which actions and should focus on encouraging and facilitating best practices for fair, effective, and transparent tax administration. The global business community should be given the opportunity to provide input to all of these workstreams and the U.S. business community, which has much at stake, should continue its participation. In order to ensure that U.S. interests are protected, it is essential that Treasury, in consultation with the tax-writing committees, continue to play an active role in all aspects of the ongoing work.

While there are significant concerns about the BEPS recommendation on country-by-country reporting, many U.S.-based companies believe it is in their interest for the U.S. to implement this requirement so that they can provide their information to the Internal Revenue Service instead of having to deal with the local reporting requirements of the many foreign countries where they have entities or branches. The IRS would share the country-by-country reports of U.S. companies with other tax authorities under the formal agreements the United States has in place for tax information exchange and subject to the U.S. rules on confidentiality of taxpayer information. If there were a problem with misuse of information in a particular country, the IRS could suspend information exchange. This approach would mean greater protection and lower administrative burdens for U.S.-based companies than the alternative of direct filing of country-by-country reports in multiple foreign countries.

Implications for U.S. Tax Reform

The United States should have a tax system that makes America an attractive place for businesses to headquarter and invest. In designing the tax system that will best support growth
in U.S. jobs and the U.S. economy, it is important to consider the tax policy choices that have been made by other countries. The current U.S. corporate tax system is an outlier relative to the corporate tax systems of our major trading partners, both in terms of the corporate tax rate and the worldwide approach for taxing the foreign income of U.S.-based companies. These features adversely affect the competitiveness of companies that are headquartered in the United States and the competitiveness of U.S. investment opportunities for foreign companies.

The OECD BEPS project and countries' actions with respect to the BEPS recommendations will dramatically change the global tax landscape. The aspects of the current U.S. tax system that detract from the attractiveness of the United States as a location to headquarter and invest will become more acute. U.S.-based companies will face new pressures in the foreign countries where they operate that will exacerbate the burden of the barrier to reinvestment in the United States that is created by the current worldwide tax system. Foreign companies also will face new pressures in foreign countries that could reduce their appetite for investment in the United States. Moreover, the foreign tax credit regime that is part of the current U.S. worldwide tax system means that the cost of increased foreign taxes on U.S.-based companies will be borne in part by the U.S. fisc through reduced residual U.S. tax when foreign earnings are repatriated.

This Subcommittee and the Ways and Means Committee have long recognized the need for international tax reform in particular and comprehensive tax reform more generally. The BEPS project and the response by foreign countries should be viewed as yet another reason why tax reform must be an urgent priority.

Thank you for the opportunity to present these perspectives. I would be happy to answer any questions the Subcommittee may have.
Chairman BOUSTANY. Thank you, Ms. Angus.
Mr. Sprague.

STATEMENT OF GARY D. SPRAGUE, COUNSEL, THE SOFTWARE COALITION

Mr. SPRAGUE. Chairman Boustany, Ranking Member Neal, and Members of the Subcommittee, thank you for inviting me to appear today on behalf of The Software Coalition to provide testimony on the impact of the OECD G20 BEPS project on U.S. software companies. In particular, how the BEPS project will reduce the U.S. tax base and create disincentives for U.S. multinationals to create R&D jobs in the United States. The members of our coalition are listed in our written submission.

Our comments today will focus on those BEPS developments of greatest significance to the U.S. software industry, namely corporate income tax nexus in countries into which our companies export goods and services, transfer pricing, R&D employment incentives, and the unraveling of consensus among countries on international tax norms. While my comments are delivered on behalf of the U.S. software industry, U.S. multinationals and other high-tech industries are similarly impacted.

First, the changes to tax treaty rules that establish when an exporter is subject to income tax in the country into which it exports goods or services. A key focus of the BEPS work was a push by market countries to obtain greater taxing rights over non-resident exporters which make sales into their countries. The BEPS work significantly reduces the threshold for income tax nexus, so that a member company of an MNC group may have to file tax returns and pay taxes in a market country, even if it has no physical presence in that country.

Second, with respect to the OECD transfer pricing guidelines, these guidelines determine how much of a group’s income is subject to tax in a particular country where that group operates. The principal effect of these transfer pricing changes will be to decrease the returns allocated to intangible property and other assets in favor of returns to people functions. This also will increase tax collections by market countries, since U.S. software companies do not hold their intangible assets in such countries.

Third, I will comment on the BEPS work regarding incentive tax regimes for R&D employment. The BEPS work recognizes that countries may set their national tax rate at any level. Most OECD member states have significantly reduced their rates of corporate income tax in recent years. At the same time, the BEPS work has created guidelines for targeted R&D employment regimes. Several countries that compete with the United States for technology investments have enacted so-called IP Box regimes that provide an even lower incentive tax rate for income derived from IP developed in their country. These rules create a strong incentive for U.S. multinationals to locate R&D functions in those countries.

Finally, I would like to comment on a particularly unfortunate side effect of the current political and administrative environment relating to international tax. In our view, the BEPS process has encouraged, or at least tacitly permitted, some countries to circumvent the normal consensus-building process at the OECD and
to act unilaterally. This stands in stark contrast to much good work the OECD has done historically to develop an international tax consensus.

On the related point, we note the EU state aid cases represent another example of foreign governments endeavoring to tax income which ultimately is part of the U.S. tax base. What, then, are the implications for U.S. tax policy? We believe that Congress should enact comprehensive international tax reform, which would include reducing the corporate tax rate to an internationally competitive rate—for example, to 25 or even 20, as some have suggested.

As part of such comprehensive reform, we favor a territorial system, such as a 95 or 100 percent dividend exemption system, consistent with other major OECD countries, and a transition rule that allows tax-favored repatriation of earnings.

Further, the United States should enact a best-in-class IP Box regime that provides an effective incentive to protect and create R&D jobs in the United States. Please see our letter of September 14 to Chairman Boustany and Ranking Member Neal, which details our recommendations on the proposal.

This proposal would provide the following benefits to the United States: Preserves the competitiveness of U.S. multinationals; it encourages the repatriation of IP by those U.S. multinationals which now hold their IP offshore, and discourages newly emerging companies from migrating their IP outside the United States in the first place; third, it would reduce the incentive for inversions through foreign acquisitions by diminishing the incentive for tax-motivated foreign takeovers; finally, it would encourage U.S. job growth and innovated industries by countering the incentives which now exist for U.S. multinationals to locate R&D jobs offshore.

The work on BEPS is not finished. Therefore, we would encourage U.S. Treasury to continue taking an active role in ongoing technical discussions to be held in 2016 and beyond. In particular, the new tax nexus rules will present U.S. multinationals with considerable unnecessary expense and increased compliance burdens.

Accordingly, Treasury should encourage our treaty partners to adopt alternative means of compliance and reasonable transition periods.

I very much appreciate the opportunity to provide testimony on behalf of the software industry, and would be pleased to answer any questions.

[The prepared statement of Mr. Sprague follows:]
1. Opening

Chairman Boustany, Ranking Member Neal and members of the Committee, thank you for inviting me to appear here today on behalf of the Software Coalition, and to provide testimony on the impact of the OECD/G20 BEPS project on U.S. software companies, and in particular how the changes to the international tax rules as developed under BEPS will significantly reduce the U.S. tax base and create disincentives for U.S. multinational corporations (MNCs) to create R&D jobs in the United States.

The Software Coalition is the leading software industry group dealing with U.S. domestic and international tax policy matters. Software Coalition members account for more than $400 billion per year in total gross revenue and $50 billion per year in total R&D spend. Member companies employ over 1.1 million individuals around the globe. The Coalition member companies are listed in our written submission.

2. Impact of BEPS on the U.S. Software Industry

Our comments today will focus on those BEPS developments of greatest significance to the U.S. software industry, including corporate income tax nexus in countries into which our companies sell goods and services (which I will refer to as “market states”), transfer pricing, R&D employment incentives, and the unraveling of consensus among countries on international tax norms. While my comments are being

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1 The Software Coalition was formed in 1990 and now comprises 23 U.S. companies which operate in the software and e-commerce sectors. The Software Coalition has been actively involved in the work of the OECD/G20 BEPS project, including participating as a business representative in a number of BEPS consultations, and submitting written comments on a number of the BEPS discussion drafts.

delivered on behalf of the U.S. software industry. U.S. MNCs in other high-tech industries are similarly impacted.

The net effect of most, if not all, of the BEPS measures will be to increase the amount of foreign tax that U.S.-based software companies with foreign operations must pay, and to increase considerably their foreign compliance burdens. The income that foreign countries are seeking to tax is ultimately part of the U.S. tax base, and increased foreign taxes will in most cases be borne by the U.S. fisc through the foreign tax credit, thereby reducing U.S. tax receipts.

Several elements of the BEPS rules create incentives for U.S. multinationals to increase high-value employment outside of the United States. These new rules place an increased emphasis on people functions over tangible and intangible assets in determining where income should be taxed. This disadvantages U.S. high-tech MNCs since those MNCs earn their income in large part from their intangible assets. The BEPS project also sets minimum standards for R&D employment incentive regimes, which create powerful incentives for MNCs to locate R&D employment outside the U.S. in order to take advantage of those regimes.

a. **BEPS Action 7 – Permanent Establishments**

We will comment first on the proposed changes to the technical tax treaty rules that establish when a company is subject to income tax in the country into which it sells its goods or services, which is referred to in our tax treaties as the "permanent establishment" standard. A key focus of the BEPS work was a push by market countries to obtain greater taxing rights over non-resident companies which make sales into their countries. To that end, BEPS Action 7 significantly reduces the threshold for income tax nexus, so that a member company of an MNC group may have to file tax returns and pay taxes in a market country, even if that separate entity does not have operations in the country. This significantly affects the U.S. software industry because U.S. software companies by and large have created cost-efficient centralized sales structures that do not rely on large sales and marketing operations in every market country, which was more common in the past. It can reasonably be expected that this lowering of the
income tax nexus threshold will result in greater income taxation in market countries on sales into such countries, above and beyond the taxable income already being reported for the sales functions actually performed in those countries. Foreign politicians have argued that U.S.-based multinationals must pay their “fair share” of tax based on “where value is created”. They argue that value is created in the market country by the act of consumption. We believe that value is created by innovation and production, not by consumption. Higher foreign income taxes imposed on U.S.-based multinationals ultimately will be subsidized by the U.S. fisc through foreign tax credits, resulting in lower U.S. income tax receipts, even if the U.S. itself never adopts the lower nexus threshold in our own tax treaties.

b. BEPS Actions 8-10 – Transfer Pricing

Second we will comment on changes under Actions 8-10 to the OECD Transfer Pricing Guidelines. These Guidelines set out the rules which allocate the income of a group between its constituent legal entities, and thus determine how much of a group’s income is subject to tax in a particular country where that group operates. In many countries, these Guidelines become operative automatically upon their approval by the OECD. The principal effect of these transfer pricing changes will be to decrease the returns allocated to intangible property and other assets, in favor of returns to people functions. This potentially will disadvantage U.S. software companies, as it will increase tax collections by countries where U.S. software companies do not hold those assets. It also will create strong incentives for U.S. MNCs to locate high-value, innovative jobs relating to the creation and enhancement of their intellectual property, like software development, in countries with lower tax rates.

c. BEPS Action 5 – R&D Employment Incentives

Third we will comment on the BEPS work under Action 5 regarding incentive tax regimes for R&D employment. The BEPS work recognizes that countries may set their national tax rate at any level. Most OECD member states have significantly reduced their rates of corporate income tax in recent years.¹

¹ Consequently, the U.S. now has the highest corporate tax rate of any major country. The U.S. 35% federal income tax rate when combined with the average U.S. state tax rate results in a combined corporate income tax rate for the U.S. over 39%. The average statutory tax rate (including sub-national taxes) of the OECD countries other than the United States is 24.8%. Accordingly, the U.S. tax rate is over 57% higher than the OECD average tax rate.
While the BEPS project is expected to increase the amount of foreign taxes paid by U.S. software companies, and also increase their administrative burdens, it is also clear that foreign corporate tax rates will remain considerably lower than the U.S. rate. The high U.S. corporate tax rate is a significant disincentive for U.S. investment in intangible property and jobs.

At the same time, the BEPS work also resulted in guidelines for targeted R&D employment regimes. Several European and other countries that compete with the United States for technology investments have enacted so-called "IP Box" regimes that provide an even lower incentive tax rate for income derived from intellectual property developed in their country. The BEPS project links the amount of the allowable incentive to the percentage of locally performed R&D, and countries are adapting their regimes to that standard. This creates a strong incentive for U.S. multinationals to locate R&D functions in those countries.

d. Lack of Consensus and Resulting Unilateral Action

Finally we would like to comment on a particularly unfortunate side effect of the current political and administrative environment relating to international tax. In my view, the BEPS process has encouraged, or at least tacitly permitted, some countries to circumvent the normal consensus building process at the OECD and to act unilaterally. This stands in stark contrast to much good work that the OECD has done over the years to develop an international tax consensus. The BEPS Action 1 final report on the digital economy, which as a practical matter principally addressed U.S. multinational business models where our companies are the global leaders in the digital economy, refrained from recommending specific changes to increase tax on companies operating in the digital economy, but specified that some countries could unilaterally introduce those changes in their domestic law, provided they respect treaty obligations. These developments have emboldened, and will continue to embolden, other tax administrations to bend established international tax principles, with a resulting increase in double taxation, international tax disputes, and greater uncertainty for U.S. multinationals.
3. Implications for U.S. International Tax Policy

The U.S. corporate tax system needs to be more competitive with current international standards. The U.S. now has the highest corporate tax rate of any major country. We believe the Congress should enact comprehensive international tax reform, which would include reducing the corporate tax rate to an internationally competitive rate—for example, to 25% or even 20%, as has been suggested recently. As part of such comprehensive reform, we favor a territorial system, such as a 95% or 100% dividend exemption system, consistent with other major OECD countries, and a transition rule that allows a tax-favored repatriation of earnings. Furthermore, the U.S. should enact a “best-in-class” IP Box regime that provides an effective incentive to protect and create R&D jobs in the U.S. Please see our letter of September 14th to Chairman Boustany and Ranking Member Neal which details our recommendations on features of the IP Box.4

Any changes to the U.S. anti-deferral rules under subpart F should not discriminate against intangible property. The existing foreign base company services income and foreign personal holding company income rules enacted more than 50 years ago are severely outdated. There is a long-standing bias in the Internal Revenue Code that royalties are passive income, while in the software industry they represent active business income. Any revisions to subpart F therefore should not impose different tax burdens on software companies due to the fact that their income arises from the exploitation of intellectual property.

A lower U.S. statutory corporate tax rate, coupled with an IP box regime, would provide many benefits to the United States. First, it would preserve the competitiveness of U.S. multinationals by imposing a competitive rate of tax on IP income. Second, it would encourage the repatriation of IP by those U.S. companies.

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4See our letter from the Software Coalition to Representatives Boustany and Neal dated September 14, 2015. That letter describes the following features of a “best-in-class IP Box: (1) provide a competitive rate for qualifying intangible income; (2) cover all forms of innovation IP, including both software and the underlying software copyrights; (3) cover the exploitation of IP through the provision of both products and services, including software as a service; (4) provide a nexus standard that is appropriate and administrable; for example, use a transfer pricing based approach to identify the income derived from qualified intangible property; and (5) provide an effective mechanism to allow the tax-free domestication of IP that is currently held offshore.
MNCs which now hold their IP offshore, and discourage newly emerging companies from migrating their IP outside the United States in the first place. This would broaden the U.S. tax base since income from intangible property which is now earned offshore would become currently subject to U.S. tax. Third, it would reduce the incentives for inversions through foreign acquisitions by enabling competitive bidding by U.S. acquirers, and diminishing the incentive for tax-motivated foreign take-overs. Finally, it would encourage U.S. job growth in innovative industries by decreasing the incentives which now exist for U.S. MNCs to locate R&D jobs offshore in countries with IP box regimes.

4. Further Work to be Done

The work on BEPS is not finished. Therefore, we would encourage U.S. Treasury to continue taking an active role in ongoing technical discussions to be held in 2016 and beyond. In particular, Treasury should continue to actively participate in the further revisions of the OECD Transfer Pricing Guidelines relating to the use of the profit split method to divide taxable income among companies in a MNC group, to ensure that the rules are not changed in a way that allows unprincipled applications of those rules to tax larger shares of the income of U.S. MNCs. Now that the definition of taxable nexus in tax treaties has been revised, 2016 will see the further work necessary to define how much taxable income actually will be subject to these new nexus rules. Treasury will need to play an active role in those discussions to ensure that the result of that work is consistent with existing international norms on what income should be taxed by a market country.

The new nexus rules will present two choices for many U.S. MNCs: they either must report a taxable presence in market countries based on sales into those countries; or restructure their foreign sales operations to avoid creating a new tax liability of the supplier entity. In both cases, U.S. MNCs will suffer considerable unnecessary expense and increased compliance burdens. Accordingly, Treasury should encourage countries to adopt alternative means of compliance and reasonable transition periods. Finally, Treasury should participate fully in the discussions about the multilateral instrument, and should continue to advocate for mandatory binding arbitration.
5. Closing

I very much appreciate the opportunity to provide testimony on behalf of the Software Coalition regarding the effects of BEPS on the U.S. tax base and U.S. jobs, and the long-term positive benefits to U.S. competitiveness of adopting international tax reform and an effective IP Box regime. I would be pleased to answer any questions.
Chairman BOUSTANY. We thank you, Mr. Sprague.
Ms. Schultz.

STATEMENT OF CATHERINE SCHULTZ, VICE PRESIDENT FOR TAX POLICY, NATIONAL FOREIGN TRADE COUNCIL

Ms. SCHULTZ. Chairman Boustany, Ranking Member Neal, and Members of the Subcommittee, thank you for inviting me to speak today about the G20 and OECD report on Base Erosion and Profit Shifting. I request that my complete statement be made part of the record.

The National Foreign Trade Council, organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. The NFTC believes the current U.S. tax law is outdated and must be modernized by enacting tax reform that reduces the U.S. corporate income tax to be more in line with our trading partners, and adopts a competitive territorial tax system that does not disadvantage U.S. businesses competing in foreign markets. Competitive U.S. tax reform would address many of the concerns raised in the BEPS project.

The Treasury Department staff should be commended for their efforts to attempt to ensure the rules that were drafted were as grounded as they could be in reasonable and objective tax law. Unfortunately, this was a difficult task, since the BEPS project was politically driven and, we believe, appeared to be aimed more at raising revenue from U.S.-based multinational corporations, rather than other global companies.

We have several concerns with the CBC report. The country-by-country report is intended to provide information that is to be used only as a high-level risk assessment tool. Completing a CBC report will be cumbersome and expensive for taxpayers, particularly for taxpayers who have operations in many countries. There are many NFTC members who operate in over 100 countries. If tax authorities release taxpayer information to the public, as some recommend, there is concern about determining the correct amount due on a tax return, based on media reports, rather than tax law. Companies understand they must share tax information on a confidential basis to the relevant tax authorities, where it can be explained in context. However, they are unwilling to be subject to audit by media spin.

It is important to note that if the United States does not require country-by-country reporting subject to confidential information exchange via the U.S. treaty network, U.S. companies will still have to comply with the reporting requirements, because each country will demand that the local subsidiaries of companies produce a global CBC report under its local variation of the rules, which will be expensive, and may expose confidential information to improper disclosure.

The NFTC hopes the United States will continue to make the case to maintain the confidentiality of CBC reporting, as the countries who participated in the BEPS project will review the implementation of the CBC reporting in 2020.

Countries are already adopting these reporting guidelines, and many are not following the BEPS report guidelines. Indeed, China has already said that it will require entire value chains to be re-
ported in all local analysis. Companies are concerned with how the information they are required to file under the master file will be used by local authorities. We believe it is important for Treasury and the IRS to provide further guidance, so companies can report their information to the IRS with section 6103-protected information exchanged via the U.S. treaty network. Otherwise, as I have noted, countries will be entitled to request it for—without section 6103 protections.

There are several other concerns that the NFTC member companies have with the final BEPS report, and I will try to get through them pretty quickly.

The action 7 on permanent establishment changes several of the longstanding definitions of what constitutes a permanent establishment, which subjects a business to income in a local country. Action 7 changed the definition of a deemed income tax permanent establishment to achieve in-country tax results under applicable transfer pricing rules. This will result in more companies being subject to tax in a local jurisdiction, and could result in potentially double or triple taxation for companies.

I am not going to spend a lot of time going over the transfer pricing rules, but we do have a lot of concern about the new rules on value creation. It is often hard to determine where value is created. In a value creation that is supposedly tied to function, it will be difficult to determine the final values, because value and function are not always linked. So we have a lot of new transfer pricing rules with new value creations. It could actually be very difficult. Some countries are adding additional value creation requirements. China is considering a value contribution method that departs from the BEPS guidelines. Location-specific advantages will be used—analysis.

The NFTC is concerned about the general aggressive global tax enforcement environment. The BEPS report action 11 analyzed base erosion and estimated how much is lost to—worldwide to aggressive tax planning. Interestingly, this analysis was not done prior to the start of the BEPS project, but only at the very end.

As countries continue their aggressive stance to collect enough taxes to counter base erosion, who will determine what enough is? If BEPS is hard to determine beyond a I-know-it-as-I-see-it standard, how will it be determined when it no longer exists? As other governments increase taxes on U.S. multinational companies, the United States is likely to provide foreign tax credits to those companies to offset double taxation on the same income. As the number of foreign tax credits increase, we will see more base erosion. But this time it will be the U.S. base that is eroded.

What can Congress do to protect the U.S. base from being eroded further? The NFTC is strongly in favor of tax reform that lowers corporate income taxes in line with our trading partners, and moves to a competitive territorial-style tax system.

Thank you for the opportunity to present the views of the National Foreign Trade Council, and I would be happy to answer any questions.

[The prepared statement of Ms. Schultz follows:]
Statement of Catherine Schultz
Vice President for Tax Policy, National Foreign Trade Council
Before the House Ways and Means Tax Policy Subcommittee
On December 1, 2015

Introduction
Chairman Boustany, Ranking Member Neal and members of the Committee, thank you for inviting me to speak today about the G-20 and OECD report on the Base-Erosion and Profit Shifting (BEPS) project.

The National Foreign Trade Council (NFTC), organized in 1914, is an association of some 250 U.S. business enterprises engaged in all aspects of international trade and investment. Its membership covers the full spectrum of industrial, commercial, financial, and service activities. The NFTC therefore seeks to foster an environment in which U.S. companies, like their foreign counterparts, can be dynamic and effective competitors in the international business arena which will increase U.S. jobs and economic growth. To achieve this goal, businesses must be able to participate fully in business activities throughout the world, through the export of goods, services, technology, and entertainment, and through direct investment in facilities abroad. As global competition grows ever more intense, it is vital that global enterprises are not subject to excessive foreign taxes, double taxation, or other impediments to the flow of capital that can serve as barriers to full participation in the international marketplace. Foreign trade is fundamental to U.S. job creation and economic growth.

The NFTC believes the current U.S. tax law is outdated and must be modernized by enacting tax reform that reduces the U.S. corporate income tax to be more in line with our trading partners and adopts a competitive territorial tax system that does not disadvantage U.S. businesses competing in foreign markets. Competitive U.S. tax reform would address many of the concerns raised in the BEPS project.

We appreciate that the business community was invited to provide input into the BEPS project through the ability to review and submit comments on the Discussion Drafts released by the Working Parties. The BEPS project was conducted during an accelerated 2 year time frame in collaboration with the OECD, the G-20 countries who are not OECD members, and 10 developing countries. Expanding the discussion beyond OECD members in this rushed environment made the discussions and consensus building much more difficult. The Treasury Department staff should be commended for their effort to attempt to ensure the rules that were drafted were as grounded as they could be in reasonable and objective tax law. Unfortunately, this was a difficult task since the BEPS project was politically driven and we believe, appeared to be aimed more at raising revenue from U.S.-based multinational corporations (MNEs) rather than other global companies.
While the final BEPS report has been issued and endorsed by the G-20, the work is not complete. There are many issues that must still be dealt with in 2016 and the years ahead. Open items include work on implementing the tax treaty recommendations to date through the multilateral instrument, work on achieving consensus on the attribution of profits to Permanent Establishments (PEs), work on achieving a consensus on how to apply profit splits where appropriate, the implementation of rules on hard-to-value-intangibles, and the implementation of rules on the treatment of headquarter activities and other low-value adding services. There are also more difficult implementation questions raised by the final BEPS report for U.S. MNEs.

Country by Country Reporting, Master File, and Local File
One of the driving forces of the BEPS project was the perception that many country’s tax auditors did not have accurate information as to the extent of a corporate taxpayer’s activities within its borders. There was a belief, that companies were not transparent enough about their operations in the countries where they had facilities. To remedy this perceived problem, new transfer pricing reporting requirements were agreed to. The final BEPS guidelines call for multinational companies to comply with three new reporting requirements. The new three-tier approach for transfer pricing documentation includes a framework for the “master file” and “local file” plus a template for Country-by-Country (CbC) reporting. The Country-by-Country report is required to be filed for and contain information with respect to a company’s first fiscal year beginning on or after January 1, 2016. For MNEs with a fiscal year that ends on December 31, the CbC report would be required to be filed by December 31, 2017, groups with other fiscal years would be required to file by 2018. Under the Country-by-Country reporting template, companies must report the amount of revenue, profits, income tax paid and taxes accrued, employees, stated capital and retained earnings and tangible assets annually for each tax jurisdiction in which they do business. MNEs are required to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities that each entity conducts. The CbC Reports are required to be exchanged on a confidential basis by governments through the exchange of information provisions included in tax treaties and Tax Information Exchange Agreements (TIEAs). The NFTC supports the CbC Reports being exchanged by Treasury as a way to protect taxpayer confidentiality. However, we have several concerns with the CbC report.

The Country-by-Country report is intended to provide information that is to be used only as a high-level risk assessment tool. Completing the CbC report will be cumbersome and expensive for taxpayers, particularly for taxpayers who have operations in many countries. There are many NFTC members that operate in over 100 countries. Company concerns include: Will proprietary information remain confidential? How should MNEs deal with different GAAP rules that apply for different entities in the global group? Some countries require local accountants, so there are questions regarding how and when are companies required to engage a local accountant? Business restructurings are common—how can this be articulated in the template? Business units within a company do not always share information and in some cases they are competitors—how is this situation reconciled on the CbC reporting template? If tax authorities release taxpayer information to the public as some recommend, there is a concern about determining the correct amount due on a tax return based upon media reports rather than the tax.
Companies understand they must share tax information on a confidential basis to the relevant tax authorities, where it can be explained in context. However, they are unwilling to be subjected to audit by media spin. It is important to note that if the U.S. does not require country-by-country reporting subject to confidential information exchange via the U.S. treaty network, U.S. MNEs will still have to comply with the reporting requirements because each country will demand that the local subsidiaries of companies produce a Global CbC report under its local variation of the rules which will be expensive and may expose confidential information to improper disclosure. These are just some of the issues companies are facing as they begin to prepare for CbC reporting. The NFTC hopes the U.S. will continue to make the case to maintain the confidentiality of CbC reporting as the countries who participated in the BEPS project will review the implementation of the CbC Reporting in 2020.

The BEPS project also requires the filing of a Master File which provides tax administrations with high level information regarding an MNEs global business operations and transfer pricing policies, including supply chain information. This information is highly proprietary and should remain confidential. Unfortunately, unlike the Country-by-Country report, the Master File must be filed directly with other governments without the protection of the exchange of information confidentiality protections. Indeed, companies will have to plan how to appropriately comply with the filing requirements in a manner that does not disclose their proprietary information to competitors.

Countries are already adopting these reporting requirements, and they are not all following the BEPS report guidelines. Indeed, China has already said that it will require entire value chains to be reported in all local analysis. Companies are concerned with how the information they are required to file will be used by local tax authorities. Countries are already becoming more aggressive in seeking information from taxpayers even before they have officially adopted by BEPS reporting standards. We understand that Australia intended to release all tax information for all MNEs until some of its domestic companies realized that their tax information would also be made public. The Australian Senate has pulled back on the proposed legislation and it is currently under further review.

We believe it is important for Treasury and the IRS to provide further guidance so companies can report their information to the IRS with Section 6103 protected information exchanged via the U.S. tax treaty network. Otherwise, as I have noted, other countries will be entitled to request for it without Section 6103 protections.

There are several other issues that concern our member companies with respect to the final BEPS
BEPS Action 7 Permanent Establishment

BEPS Action 7 recommended several changes to the longstanding definition of what constitutes a permanent establishment which subjects a business to income tax in a local country. Action 7 changes the definition of a "deemed" income tax permanent establishment (PE) to achieve in-country income tax results under applicable transfer pricing rules. This will result in more companies being subject to tax in a local jurisdiction, yet we are still waiting for the OECD work to begin to define how to measure the profits, if any attributable to these deemed PEs. Without full agreement between countries on income attribution, taxpayers have no idea how much income is subject to a "deemed PE". We are very concerned that there will not be agreement and taxpayers will be facing real risks of double or triple taxation. As these taxes imposed on deemed PEs are potentially eligible for a foreign tax credit on U.S. tax returns, this has an impact on the US fisc.

Further, we are not aware of any discussion, or even recognition, of the many potential collateral consequences of changing the PE definitions. For example, it is not clear whether the "deemed" PE will be treated as a PE for VAT purposes or customs purposes or legal business registration purposes. In the face of these uncertainties, diligent taxpayers simply trying to comply may have to create accounting systems, invoicing systems, customs processing systems, procurement and ordering systems and many other systems which are expensive and will take years to implement. We believe that the critical goal for tax administrations and taxpayers should be ensuring that the appropriate amount of tax due is reported and paid to the tax authorities without creating undue burdens or areas of unnecessary dispute. The U.S. must work with the other countries to agree that a deemed income tax PE does not create a deemed VAT PE or a deemed change in who is obligated for customs duties and importation compliance and that there be a sufficient transition period so taxpayers can actually comply.

For most countries, more revenue is raised from their VAT systems than through the income tax systems. The U.S. is the only OECD country without a VAT, and all U.S. MNEs must comply with the VAT guidelines and collect and remit VATs to the countries where they are selling or operating. By lowering the threshold for what constitutes a PE for VAT purposes, some governments are being aggressive and are insisting that companies that have agents for VAT collection and remission, also have a PE for income tax purposes. The BEPS Guidelines specifically state that an agency for VAT collection should not create a PE for direct tax purposes, but this is just one area where countries are already going outside the guidelines set out in the BEPS report to implement their own more aggressive rules to the detriment of U.S. MNEs and against the interests of the United States.

Transfer Pricing

Actions 8-10 of the BEPS report will lead to changes in the OECD Transfer Pricing Guidelines.
There were considerable changes to the transfer pricing rules that raise concern for taxpayers. The Treasury Department did an admirable job of insisting that the arm’s length standard be retained for transfer pricing purposes as some countries continued to push for moving to a more formulaic apportionment standard. The BEPS project guidance on applying the arm’s length principle provides guidance on identifying the actual transaction undertaken, on what is meant by control of a risk, and on the circumstances in which the actual transaction undertaken may be disregarded for transfer pricing purposes. For the taxation of intangibles, the final BEPS report provides guidance on which entity or entities are entitled to share in the economic return from exploiting intangibles. The final report provides that mere legal ownership of an intangible does not confer any right to the return from its exploitation. Instead, the economic return from intangibles will accrue to the entities that perform the important value-creating functions of developing, enhancing, maintaining, protecting and exploiting the intangible, and that assume and manage the risk associated with those functions. It is often hard to determine where value is created. Although the final report confirms that database comparables are seldom appropriate for pricing intangible transactions, and provides guidance on the use of other valuation techniques that may be more applicable, there is no objective measure on how to determine value creation. If value creation is supposedly tied to function, it would be difficult to determine the final value because value and function are not always linked, and because there is no international consensus on how to allocate profits where value-creating functions occur in more than one location. Some countries are adding additional value creation requirements. China is insisting on a “value contribution method” that departs from the BEPS guidelines. Location specific advantage will be used in comparability analysis. The taxation of intangibles is one of the most controversial aspects of the BEPS report and is likely to result in more tax being paid by US MNCs to foreign jurisdictions. Countries will try to look at leading U.S. companies and try to raise more revenue through more aggressive audits of the transfer pricing of intangibles.

The implementation of the guidelines for hard-to-value-intangibles will not be completed until 2016. At the beginning of the BEPS project, there was a great deal of discussion of “special measures” where the normal transfer pricing arm’s length standard would not apply. Under the hard-to-value-intangibles draft when intangibles are transferred or licensed in development or where there value is uncertain, the tax administration is entitled to use the ex post evidence about the financial outcomes to determine the arm’s length pricing arrangements, including any contingent pricing arrangements, that would have been made between independent enterprises at the time of the transaction. These rules do not take into consideration the significant risks associated with the commercialization of any intangible. It is impossible for a company to accurately predict the outcome of research and development. What if your main competitor goes bankrupt? What if the product developed is similar to another product brought on the market with similar characteristics? We are concerned that the BEPS report includes subjective terminology relating to “satisfactory evidence” and “significant” differences between expectations and outcomes. Companies are concerned that tax authorities will use ex post information in any situation where reliable comparables are not available to support the pricing of any significant intangible. This will result in more tax disputes.

The implementation of the guidelines on headquarters activities and other low value-adding services will not be implemented until 2018. The purpose of these rules is to mitigate double
taxation by ensuring that expenses for headquarters and other support activities are deductible once in the appropriate jurisdiction. This work is of disproportionate importance to the United States and U.S. MNEs given the fact that a disproportionate amount of headquarters and other corporate support activities occur in the United States. Accordingly, companies are concerned that this aspect of the BEPS work will continue to be deferred or will not be implemented with as much vigor as other aspects of the project.

**Dispute Resolution - Mandatory Binding Arbitration**

The NFTC strongly supports the inclusion of a mandatory binding arbitration clause in the multilateral instrument currently being drafted by the BEPS project member countries. Over 20 countries have already agreed to include mandatory binding arbitration in their treaties. We are also pleased that the new U.S. Model Tax Treaty will include a mandatory binding arbitration provision. As countries become more aggressive in their application of rules under the guise of the BEPS report, we are greatly concerned that the number of disputes will significantly increase. Without the mandatory binding arbitration provision, countries would have no incentive to resolve tax cases in a timely manner. At a time when the IRS budget is constrained and the Competent Authority has more limited resources, there must be a way to resolve tax disputes between countries in an efficient manner.

**Conclusion**

The NFTC is concerned about the general aggressive global tax enforcement environment. The BEPS report Action 11 analyzed base erosion and estimated how much is lost worldwide to aggressive tax planning. Interestingly, this analysis was not done prior to the start of the BEPS project, but only at the very end. If it was an objective concern, and not a political project, the amount of base erosion would have been examined at the outset of the project, not at the very end of it. As countries continue their aggressive stance to collect “enough” taxes to counter base erosion, who will determine what “enough” is? If BEPS is hard to determine beyond an “I know it when I see it” standard, how will it be determined when it no longer exists? As other governments increase taxes on U.S. multinational companies, the U.S. will provide Foreign Tax Credits to those companies to offset double taxation on the same income. As the number of Foreign Tax Credits increases, we will see more base erosion—but this time, it will be the U.S. base that is being eroded.

What can Congress do to protect the U.S. fisc from being eroded further? The NFTC is strongly in favor of tax reform that lowers corporate income tax rates in line with our trading partners and moves to a competitive territorial-style tax system. Revenue that effectively is part of the U.S. tax base, is being claimed by other countries. It is not their revenue, it is ours, and modernizing the U.S. tax system will ensure that companies will have the ability to increase their investments and jobs in the U.S.

Thank you for the opportunity to present the views of the National Foreign Trade Council on this important subject. I would be happy to answer any questions.
Chairman BOUSTANY. We thank you, Ms. Schultz.

Mr. Sullivan.

STATEMENT OF MARTIN A. SULLIVAN, PH.D.,
CHIEF ECONOMIST, TAX ANALYSTS

Mr. SULLIVAN. Good morning, Chairman Boustany, Ranking Member Neal, Members of the Committee. Thank you for inviting me to discuss the BEPS project and its effect on the U.S. economy.

In 2013, the OECD initiated the BEPS project to address the flaws in the international tax system that allowed multinationals to shift profits but not corresponding business operations from high- to low-tax countries. At the core of the OECD’s response is a focus on aligning taxable profits with value creation with economic activity, with economic substance. This is likely to have significant consequences for the competitiveness of multinationals, on how multinationals allocate investment across borders, and on how countries engage in tax competition.

Check-the-box regulations issued in 1996 made it easier for U.S. multinationals to shift profits into tax havens. The BEPS alignment of taxable profits with business operations would take much of the juice out of these—out of this check-the-box tax planning. In 1998, when Treasury wanted to withdraw check-the-box regulations, many questioned why the United States should have rules that help foreign governments collect taxes. Now it is the BEPS project that will help foreign governments collect taxes.

Before, multinationals could lower their taxes with tax planning that had minimal impact on real activities. Now, to lower taxes, they will be required to shift jobs and capital investment to low-tax countries. If BEPS succeeds, we will be entering a new era when cross-border profit shifting is replaced with cross-border shifting of jobs and of capital.

Countries with low tax rates and real economies, countries like Ireland, Singapore, Switzerland, and the United Kingdom, are the likely winners. Their gains will come at the expense of high-tax countries that will lose jobs and will lose investment. With a combined Federal-State rate of 39 percent, the United States is particularly vulnerable.

The likely response by foreign parliamentary governments that can more easily change their tax laws will be to set their corporate rates even lower than they are now. The UK has already announced that it will reduce its corporate rate to 18 percent in 2020. Competition for real activity will increase. The already problematic effects of the high U.S. corporate rate will be compounded by these rate cuts.

Reducing the corporate tax rate has always been a top priority. The BEPS project will raise the stakes. The critical question is how do we pay for it. The economics of corporate tax reform are trickier than most people realize. It is entirely possible that any revenue-neutral corporate tax reform that rolls back investment incentives will impede and not promote economic growth.

At the top of the list of usual suspects to pay for a rate cut is a reduction in depreciation allowances. Unfortunately, the positive growth effects of a rate cut are more than offset by the negative effects of slower capital recovery. If you add to that capitalization
of R&D, as proposed by Chairman Camp, you have a tax reform that penalizes capital formation, with the heaviest burden on domestic manufacturing.

Clearly, to boost America’s competitiveness, we need a new approach. Revenue neutrality within the corporate sector is not a useful guiding principle for 21st century tax reform. We need to downsize our most economically damaging tax and replace those revenues with revenues from other sources.

One option is for the United States to follow the example of other nations and adopt a value-added tax. This would greatly enhance U.S. competitiveness because revenue from the capital-repelling corporate tax would be replaced with a highly-efficient consumption tax.

Another approach would be to shift away from taxing business entities and toward taxing investors. The main advantage of this approach stems from differences in cross-border mobility. Investors are less mobile than investment. Most OECD countries have raised shareholder taxes, while cutting their corporate taxes. And because the burden of corporate taxation is increasingly falling on labor, a shift from corporations to shareholders will increase progressivity.

On the international side, the Camp approach to territorial taxation, including all of its strong anti-base erosion provisions, still seems correct. We need to banish lock-out from our international tax rules. To the extent we impose any tax on foreign profits, we should levy that tax as profits are earned, not when they are distributed.

We need strong and tough earnings stripping rules. It is common practice for foreign-headquartered multinationals operating in the United States to cut their U.S. tax by paying interest to foreign affiliates. Earnings stripping is a major motivation for inversions.

Finally, as proposed by Chairman Camp, we need to adopt a one-time tax on unrepatriated foreign profits. From an economic perspective, this tax is as good as it gets. As a tax on old capital, it does not affect incentives on new investment. Congress should consider a deemed repatriation proposal with rates substantially higher than those proposed in the Camp plan, and use those revenues for tax cuts that promote domestic jobs and domestic capital formation.

Mr. Chairman, thank you very much.

[The prepared statement of Mr. Sullivan follows:]
Testimony of Martin A. Sullivan, Ph.D.
Chief Economist,
Tax Analysts

Before the Subcommittee on Tax Policy of the
Committee on Ways and Means,
U.S. House of Representatives

December 1, 2015 10:00 a.m.

Hearing on the OECD Base Erosion and Profit Shifting (BEPS) Project

Good morning, Chairman Boustany, Ranking Member Neal, and Members of the Committee. It is a pleasure to appear before you today to discuss the OECD’s project on base erosion and profit shifting (BEPS) project and its effects on the U.S. economy.

In 2013, at the request of the leaders of the G-20 nations, the OECD initiated the BEPS project to address the flaws in the international tax system that allowed multinational corporations to shift profits—but not corresponding business operations—from high-tax to low-tax countries. This idea of aligning profits with value creation was entirely consistent with tax reform efforts of the chairmen of the tax-writing committees who at the time who stated: “We’ll make sure that companies can’t avoid paying tax on income they earn in the U.S. by pretending that they earned it in an overseas tax haven.”

Now that most of the BEPS project is completed there is a great deal of commentary about how foreign governments, acting on the OECD’s recommendations, will begin taxing profits currently being booked in tax havens. To the extent BEPS principles are implemented, it is likely that the foreign tax burden on U.S. multinationals will rise—especially for those multinationals with lots of intellectual property.

With the release of the check-the-box regulations by the Treasury Department in 1996 it became much easier for U.S. multinationals to reduce their foreign taxes by shifting profits from

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1 The views here are my own and not those of Tax Analysts. Founded in 1970 as a nonprofit organization, Tax Analysts is a leading provider of tax news and analysis for the global community. By working for the transparency of tax rules, fostering increased dialogue between taxing authorities and taxpayers, and providing forums for education and debate, Tax Analysts encourages the creation of tax systems that are fairer, simpler, and more economically efficient. Tax code should minimize its role in the economy by rechanneling the revenues devoted to tax breaks into lower rates.


countries where they conduct most of their business into tax havens. The BEPS recommendations that align taxable profits with value-creating business operations have the potential to take much of the benefit out of this type of check-the-box tax planning. In the 1990s when Treasury wanted to repeal check-the-box regulations many in Congress and the business community questioned why the United States should have rules that help foreign governments collect taxes on U.S. multinationals. Similarly, many are now asking why the United States should support the BEPS project that will help foreign governments collect taxes on U.S. multinationals.

The Economics of Economic Substance

Before discussing how the United States should respond to what some call a “revenue grab” by non-tax haven foreign governments, we should take a moment to discuss another aspect of the BEPS project that also has important economic implications for the United States. Here we are not so much talking about the effect of BEPS principles on competitiveness of U.S. multinationals but about the effect of BEPS principles on the location of multinationals’ business operations.

From the start of the BEPS project the focus has been on preventing artificial profit shifting, that is, the shifting of profit achieved by related-party loans, related-party risk shifting contracts, the relocation of rights to intangible property, and adjustment of transfer prices. Through this elaborate “supply chain restructuring” multinationals have been able to shift taxes from high-to-low-tax countries usually without a commensurate shift in employment and tangible assets.

To the extent the BEPS project is successful in aligning taxable profits with real activities there will be less artificial profit shifting, more revenue for governments where economic activities take place, and higher taxes on multinationals. But that is not the end of the story. Where before multinationals could lower their taxes with clever tax planning that had minimal impact on real activities, they will now be required to shift jobs and capital investment to low-tax countries to cut their tax bills. With the implementation of BEPS principles, the problem of large tax rate differentials will be much less about cross-border loss of revenue and much more about cross-border shifting of jobs and capital spending.

In general, efforts by tax administrators to require more economic substance—for example, to prevent tax shelter transaction—is widely considered to be good tax policy. What is often forgotten is that adding friction to aggressive tax planning can have the unfortunate side effect of increasing the economic distortions of taxation. In the context of international tax planning, requiring economic substance means shifting real business operations to low-tax countries in order to justify booking profits in those countries. Therefore, requiring alignment of economic activities and taxable profits can either attract or drive away investment.

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4 Treasury Decision 8697.
5 Notice 98-11.
Countries with low tax rates and with substantial economies that are platforms for real investment—countries like Ireland, Singapore, Switzerland, and the United Kingdom—are likely to be winners. Gains to these countries will come at the expense of high-tax countries that will lose jobs and investment. With a combined federal-state tax rate of 39 percent the United States is particularly at risk.

**Heightened Tax Competition**

The OECD's BEPS project is telling governments that profits must be aligned with substantial value creation. If these principles are adopted, we could be entering a new era where rate differentials take on heightened significance. The likely response by foreign parliamentary governments that can more easily change their tax laws and are willing to pursue a tax competition agenda will be further reductions in their corporate tax rates. Thus, the already problematic economic effects of a high U.S. corporate tax will be compounded by rate cuts of foreign governments responding to BEPS. Reducing the corporate tax rate has always been a top priority of economic policy. The BEPS project has raised the stakes.8

The critical question is how do we pay for a lower corporate tax rate?

The tepid response to former Ways and Means Committee Chairman Camp's prodigious tax reform efforts demonstrates the political obstacles to tax reform. It has been five years since Simpson-Bowles Commission put tax reform on the front burner. But since then there has not been one tax reform proposal that has come close to coming up for a vote in either the House or Senate tax-writing committees.

That's the politics of tax reform. Then there are the economics of tax reform. It is entirely possible that any revenue-neutral corporate tax reform that rolls back investment incentives to pay for a corporate lower rate will impede—not promote—economic growth. Unlike 1986, there are not many big-money tax breaks available to pay for a corporate rate cut, and a substantial portion of those tax expenditures that could be repealed to finance a rate reduction are not loopholes but incentives for domestic investment.

At the top of list of "usual suspects" to pay for a corporate rate cut is a reduction in depreciation allowances. Unfortunately, the positive growth effects of a rate cut (which rewards old and new capital) would be more than offset by negative effect of slower of capital recovery (which is borne entirely by new investment). If on top of that you include capitalization of research expenditures and cuts to the research credit, as proposed by Chairman Camp, you have a tax reform that penalizes capital formation with the heaviest burden on domestic manufacturing.

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8 In July of 2015 the British government announced its intention to reduce the United Kingdom's corporate tax rate to 19 percent in 2017 and to 20 percent in 2020.

9 In a very recent article Daniel A. Witt makes the same point: "Another unintended consequence of BEPS is that the competition for real economic activity (e.g., physical plants and production sites) will increase, and likely lead to continued downward pressure on corporate income tax rates." (Tax Notes International, Nov. 20, 2015, p. 759)
Any cut in the corporate tax rate is a welcome development. So if the Congress can find a way to cut the U.S. rate from 35 to 30 percent or through base broadening reforms that do not reduce investment incentives it should not let the perfect be the enemy of the good. But this still leaves the United States with a clunky corporation tax that is poorly suited to the modern international economy.

Clearly if we want a tax reform that will substantially improve America’s competitiveness we must begin to think differently. We must look beyond cuts in corporate tax expenditures as source of revenue to pay for corporate rate cuts. Revenue-neutrality is not a useful guiding principle for 21st century corporate tax reform. For all its merits the Tax Reform Act of 1986 is not a model for our next tax reform. We must begin to think about replacing revenues from our most economically damaging tax with revenue from new sources.

One option would be for the United States to follow the example of other nations that have cut their corporate tax rates and adopt a value added tax. A reduction in the corporate tax rate to 15 percent could be paid for by a 5 percent value added tax. This would greatly enhance the competitiveness of the U.S. economy because the revenue from the capital-repelling corporate tax would be replaced with a highly efficient consumption tax. Senate Finance Committee member Benjamin Cardin, D-Md., has proposed that the revenues from a federal value-added tax with a 10 percent rate be used to pay for large cuts in individual and reduction in the corporate tax rate to 17 percent.

**Tax Investors, Not Investment**

Another straightforward and economically intriguing concept is a tax reform that shifts tax away from business entities and onto investors. The main advantage of shifting taxes on capital to the personal level stems from differences in cross-border mobility. Investors are less mobile than investment. Most people are unwilling to uproot families, leave friends, and adopt a new culture just to save taxes. For a profit-maximizing corporation, however, an international relocation is just a matter of dollars and cents. And with improved communications the costs of spreading business operations across the globe are decreasing.

The idea that we must shift taxes on corporations to taxes on investors is gaining increasing acceptance among policy experts on both side of the aisle.

In a 2010 paper economists Rosanne Altshuler, Benjamin Harris, and Eric Toder explored the possibility of returning the top dividend and capital gains rates to their pre-1997 level of 28 percent. They made several interesting findings: First, most OECD countries have moved in the opposite direction of the United States and have raised shareholder tax rates while lowering corporate rates. Second, because the cross-border mobility of individuals is less than that of corporations, such a change would reduce tax distortions in economic decision-making. Third, because the burden of corporate taxation is believed to increasingly fall on labor, a shift in tax from corporations to shareholders would increase the progressivity of the tax system.10

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In 2011 testimony before the Senate Finance Committee, Professor Michael Graetz of Columbia Law School, a former Treasury official, stated that the Treasury Department traditional view of favoring reductions in shareholder taxes over reductions in corporate taxes has not withstood the test of time because of the “internationalization of the economy.” Graetz told the committee that “It is far easier and, I believe now better tax policy, to collect income taxes from individual citizens and resident shareholders than from multinational business enterprises.” He then suggested that Congress consider a cut in the corporate rate to 15 percent and a tax increase on individuals in the form of a withholding tax on corporate shareholders and bondholders.

And just last week James Pethokoukis of the American Enterprise Institute wrote: “Perhaps it is time for a new approach, with one economically obvious reform being a shift of corporate income taxation from the corporate level to that of the individual shareholders.” Similarly, Alan Viard, also at the American Enterprise Institute, has stated: “We need to base our tax on where the stockholders live. We should give up this idea of taxing income at the corporate level, and instead say American shareholders should pay tax every year at full ordinary income rates on their dividends and their capital gains from any company no matter where the company is chartered or managed or where it earns its profits, and that tax should apply regardless of whether the stockholders sold the stock or not.”

**BEPS and International Tax Reform**

In the prior section I argued that BEPS provides extra motivation for Congress consider new and bold approaches to domestic corporate tax reform that differ considerably from the approach taken by Chairman Camp last year. The best way for the United States to respond to BEPS is to lower its corporate rate and to maintain or even expand well-designed investment incentives. On the international side—although many details that are yet to be settled—the basic thrust of the Camp approach to territorial taxation, including all of its strong anti-base erosion provisions, still seems correct.

First and foremost, we need to banish lock-out from our international tax rules. I am skeptical of the magnitude of economic benefits that some claim will arise from removing the tax penalty from repatriation of foreign earnings. Nevertheless, there are negative consequences of lock out. And the problem is easily solved by imposing domestic tax (if any) on foreign profits when profits are earned instead of when they are paid as dividends to the U.S. parent.

We also need tough earnings stripping rules. It is common practice for foreign-headquartered multinationals to shift income out of the United States by paying interest on related-party loans from foreign affiliates. Because U.S. controlled foreign corporation rules prevent this, the ability to strip earning is a major motivation for U.S. headquartered companies to invert. To encourage foreign headquartered multinationals to invest in the United States we should replace tax benefits for debt with tax incentives for capital expenditure.

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Interestingly, if the United States fully embraced the BEPS principle of aligning profits with value creation, there would be less need for the tough anti-base erosion rules in Chairman Camp's proposed reform or for a minimum tax as proposed by President Obama. This would be a welcome development because it is difficult to design such rules that are both administrable and effective. 

Finally, the Camp proposal to apply a one-time tax on the stock of accumulated foreign earnings (so called "deemed repatriation") should not only be fully embraced, it should be expanded. Under the Chairman Camp's plan unrepatriated foreign earnings currently held as cash would be taxed at 8.75 percent and other unrepatriated earnings invested in active business would be taxed at 3.5 percent. The Joint Committee on Taxation estimated this proposal would raise $170 billion over ten years. From an economic perspective, this is about the most efficient tax possible—even better than a consumption tax—because as a tax on old capital it does not affect incentives to invest on a going forward basis. Therefore, in order to pay for rate cuts and tax incentives that would promote domestic capital formation and job growth, Congress should give high priority to the a deemed repatriation proposal with rates considerably higher than those proposed by Chairman Camp.

Thank you for the opportunity to discuss these important issues. I am happy to answer any questions that the committee may have.

Chairman BOUSTANY. Thank you, Mr. Sullivan. We will now proceed with questions. Let me start with Ms. Schultz and Ms. Angus.

Under the BEPS action item 13, the master file information that is required is something of concern. We had some discussion on it earlier. Based on what we know today, what recourse does a company have if it discloses sensitive business information to a foreign jurisdiction and that information gets out to a foreign competitor?

Ms. SCHULTZ. Yes. I think, as Mr. Stack said, companies have to work very hard to try to make sure that whatever information is provided is not proprietary. But a lot of countries are requiring that information.

So, you may say, “I am going to put this much information on, and if they ask for additional information they can do it through the audit process and we will then, you know, have a separate conversation to review that information,” but the way it is set up right now, a lot of these governments are already making these changes, and are going to require that information. It is going to be very difficult, if information is required and it doesn’t go through an exchange of information provision, for companies to be able to control what happens with that information.

There is also a big push by some of the civil society to make sure that as much information gets published as possible. They think that to have corporate transparency you need to have all the tax information out in the public. So a lot of the proprietary information that companies really hold very tightly, especially value chain information, is stuff that they are very concerned could get released or could get given to some other governments, or through civil society, and released in another way.

Chairman BOUSTANY. Thank you. Ms. Angus, do you want to comment?

Ms. ANGUS. I agree with——

Chairman BOUSTANY. Please turn your microphone on.

Ms. ANGUS. I agree with the comments by Ms. Schultz, and also Mr. Stack, that the master file is an important document to focus on. Because it is a more extensive document than the country-by-country report, it can provide more information. It is in narrative form. So precisely what information is provided and how it is described is in the hands of companies, and they will need to approach this very carefully to be compliant with the requirements but give themselves as much protection as they can.

Once a master file is provided to a government, as with any other information that a company has to provide to the tax authority, it then falls under that country’s rules as to the protection of that information, and we certainly have seen experiences where U.S. companies have had unfortunate experiences in the past with countries not protecting information the way that it is protected in the United States.

I think that is an important issue to be considered as the work in the OECD goes forward. The OECD has an opportunity to take a leadership role here and get countries really focused on the price of obtaining the information that they want about companies has to be to protect that information.
Chairman BOUSTANY. I thank you. And I see in the country-by-country reporting it is limited to large multinational groups with consolidated group revenue of at least 750 billion Euro. Does the master file disclosure requirement in action 13 have similar restrictions?

Ms. ANGUS. It does not have those restrictions, as specified by the OECD. And the countries that have already begun to adopt the master file have not always put in any restrictions. So it could apply to any company of any size.

Chairman BOUSTANY. I thank you. And finally, a question for Mr. Sprague.

BEPS was supposedly meant to level the playing field and address tax evasion and tax avoidance in an even-handed fashion. Can you elaborate further on how BEPS is encouraging the creation of IP regimes in various countries? Are these patent boxes, or innovation boxes, likely to effectively force companies that use a lot of intangibles to move operations out of the United States?

Mr. SPRAGUE. Thank you, Mr. Chairman. The short answer to the last question is yes. The BEPS process, very interestingly, resulted in, essentially, a setting of minimum standards for IP boxes. So even though general corporate tax rates outside of the United States are lower, considerably lower, than the U.S. rate, every country that has adopted an IP box will have an even lower rate for income in the IP box. It is remarkable, how many countries have either already adopted or are intending to adopt an IP box. The rate in the UK, for example, is 10. The rate in Ireland is likely to be 6.25. Those are very powerful incentives.

The agreement that has come up through the BEPS process essentially is to establish a connection, a very direct connection, between the amount of income that can be taxed in the IP box and the amount of R&D development activity that is performed in the country. So, as a consequence, the very direct result of the IP incentive is to incentivize all companies—U.S. companies included—to move R&D functions into the countries that offer such IP boxes.

Chairman BOUSTANY. I thank you.

Mr. Neal.

Mr. NEAL. Thank you much, Mr. Chairman.

Mr. Sprague, you correctly noted that many of our competitors, particularly in the G20, have lowered their corporate rate. And you cited the British, for example, as Mr. Sullivan did. Simultaneously, while lowering that corporate rate, Prime Minister Cameron is now calling for more defense spending. Who is going to make up the difference in revenue?

Mr. SPRAGUE. Well, that is a political question that I guess——

Mr. NEAL. I am going to give Mr. Sullivan a shot at it, as well.

Mr. SPRAGUE. You guys get to—you get to decide. You know, my—from an international corporate tax competitiveness perspective, I am a private practitioner. You know? I work with companies. They ask me what the tax rate is outside the United States compared to the United States, and I tell them. And that provides a very powerful incentive for them to move operations outside the United States.

And one very important result of the BEPS process—I think Ms. Schultz commented on this—the transfer pricing changes, in par-
ticular, are going to encourage companies, our clients, U.S. multinationals, U.S. software companies, to put high-value jobs outside the United States, because it is those high-value jobs that are going to solidify the foreign structures to make them stand up better to challenges of the market jurisdictions.

Mr. NEAL. Mr. Sullivan.

Mr. SULLIVAN. Thank you, Mr. Neal. You know, the question keeps coming up over and over again. Or it doesn’t—actually, it doesn’t come up enough. How are we going to pay for a lower rate? I am in favor of a low corporate rate. I would go to 10—I would go to 15 percent to 10 percent. But we have to find alternative sources of revenue. Obviously, a value-added tax is not very popular in the U.S. Congress right now, although it is what other countries have done to lower their corporate taxes. And perhaps the more realistic alternative that you also see in other countries is raising taxes on shareholders, raising taxes on investors.

So you would move the point of imposing tax on capital away from the mobile corporations that can move outside of the United States and place that burden on shareholders. And you see more and more in the academic community experts are recognizing that this is a far better approach than trying to impose tax on corporations.

Mr. NEAL. Thank you. And, Mr. Sprague, how much of the trapped cash that U.S. multinationals have held overseas is attributable to software companies, do you know?

Mr. SPRAGUE. I don’t know, offhand. I mean there are many industries that have trapped cash overseas. I think there are articles that publish those statistics from time to time.

Mr. NEAL. What is the software industry currently doing with that money?

Mr. SPRAGUE. Generally, the money is used to reinvest outside the United States, reinvest in operations outside the United States, make acquisitions outside of the United States. Because of the lockout effect of U.S. tax law, the income or the cash can’t be divested back to the United States without the punitive U.S. tax. And so it is much more efficient to deploy that cash to grow business operations outside the United States.

Mr. NEAL. Mr. Sullivan, do you want to comment on that?

Mr. SULLIVAN. Well, the—I think one—maybe one way of thinking about this is what will they do with the money if the money is brought——

Mr. NEAL. That is the point, yes.

Mr. SULLIVAN [continuing]. If they are allowed to bring it back. And we saw, back in 2004, when we had a repatriation holiday—I don’t know about specifically the software industry, but, despite all of the discussion about how it was going to be used for investment and plant and equipment and job creation, most of it went into paying dividends and share buybacks.

Mr. NEAL. And I think that is the point. And I—having experienced that moment, when it was suggested that the repatriated money could be used for job creation, that certainly—we—there is broad agreement today that certainly did not happen.

Mr. SULLIVAN. And you know, we certainly want to get rid of the lockout effect.
Mr. NEAL. Exactly.
Mr. SULLIVAN. We don’t want to have that money trapped off-shore.
Mr. NEAL. Right.
Mr. SULLIVAN. But I think some of the claims about how much benefit we will get for it as being a major stimulus that will transform the economy is a little bit overblown.
Mr. NEAL. You know, there seems to be some consensus amongst the panelists that trying to get that money back at a reasonable rate would be very productive for America’s economic purpose. And I think that is where we ought to be focusing our attention, but not to miss the point that that argument was made here.
I was on the Committee at the time and objected strongly to the notion that that money should be brought back at five and a quarter. And it was brought back at five and a quarter. And even the most aggressive proponents of bringing that money back later acknowledged not only did they not do any hiring, but that the money was given to the shareholders, and it was called good management. Now, that is up to them to make the determination. But not to miss the point, under the guise of job creation, that money was returned.
Thank you, Mr. Chairman.
Chairman BOUSTANY. Mr. Reichert.
Mr. REICHERT. Thank you, Mr. Chairman. Thank you all for being here, and for providing your testimony, taking time out of your busy schedules to be with us today. Just a quick followup question on BEPS action 13 that the Chairman was pursuing.
I would just like a little bit of a—more elaboration, Ms. Angus, on—and Ms. Schultz—on what other countries are doing. So you have referenced the more than 60 countries in the last 2 years that are now taking actions related to BEPS action 13. So what are those actions that other countries are taking, and how do they affect the United States? Either one of you would be——
Ms. ANGUS. With respect to country-by-country reporting—in particular, we have seen a flurry of activity starting before the OECD final reports, but speeding up since the issuance of the reports last month. And there are three countries that have already adopted country-by-country reporting: Mexico, Poland, and Spain. There are several others that have legislation in the process that is expected to be completed shortly that will have country-by-country reporting in place, and many other countries are considering it.
At the same time, there are countries that have also acted with respect to putting in place master file requirements.
Ms. SCHULTZ. I agree with Ms. Angus, that you start to see the countries that originally were called unilateral actors. Now they are called early adopters, before the BEPS report was finished. It just sort of changed the dialogue a little bit on who was doing what.
But just by putting the BEPS action report—by starting the BEPS project, countries already started to make changes in their tax laws, and said that they were doing it because of BEPS. There were a lot of countries doing tax reform. There are countries that
have started to add the—as Barbara said, countries are already starting to do the things from the BEPS action report, but a lot of them started well before the BEPS project was finished. There was a lot of tax reform taking place. There were a lot of countries taking a look at their rules, both indirect and direct taxation on how they were taxing the income that they considered to be the BEPS income, the base erosion income.

And one of the things that Mr. Sullivan said about the VAT, a lot of governments, because the United States is the only OECD country without a VAT system, a lot of these governments had already started to look at the VAT and said, “If you need a specific agent for VAT purposes, we will give you a PE for direct tax purposes.” So governments have started to try to figure out a way to get more income tax from U.S. multinationals in many other ways, not just looking at the CBC and the master file.

So, by doing these early actions, there has been an awful lot of activity prior to the finish of the BEPS project, where companies have had to be more aware of where the changes were coming.

Mr. REICHERT. And what are the impacts on American companies?

Ms. SCHULTZ. It is much more expensive for American companies. We are seeing companies—just the complication of complying with all these different rules, and paying attention to who is changing their rules under which—at which time, it is becoming a little bit more difficult for companies to make sure that they are ready to comply with all these different rules.

It has also increased the number of disputes already, significantly. The number of audits is up. And the number of disputes is going to go up substantially, as well.

Mr. REICHERT. Ms. Sprague—or Angus, I am sorry.

Ms. ANGUS. I would just add that it—certainly change is happening like this all around the world. At the same time it creates significant uncertainty. In many cases the changes are not fully described or detailed, so there is uncertainty about how the rules will be applied.

And we are seeing an increase in tax authorities using the label of BEPS to justify challenges of companies under current law. So, potential for significant retroactive effect, where the law hasn’t been changed, but they are using this as an excuse to make a challenge against a company.

Mr. REICHERT. Thank you, and I yield back, Mr. Chairman.

Chairman BOUSTANY. Mr. Larson.

Mr. LARSON. Thank you, Mr. Chairman, and I thank all of the panelists for your testimony.

Mr. Sullivan, if I could, I would just like to ask a couple of questions. And one of them—and what I appreciate about these hearings—and I want to say, Mr. Chairman—is that this provides us an opportunity to demystify for the American public a lot of the terminology that we utilize. I can imagine someone tuning in—I don’t think our ratings are probably that high, but I can imagine someone tuning in and listening to the conversation here, and when I go home to Augie and Ray’s and I talk about the lockout effect, and I talk about base erosion and earnings stripping and
check-the-box, et cetera, they kind of look at me and say, “Well, yes, but what are you doing about jobs.”

And while I do think that there is a direct correlation between these, Mr. Sullivan, if you could, briefly discuss how we can make changes to some of our international tax rules to help grow jobs in this country, while preventing the further base erosion, if possible. And then I would like you to expand upon what you had to say about what is going on in academic circles about a discussion—you and Ms. Schultz mentioned the VAT tax. Probably the unlikelihood of that happening, but the thinking as it relates to shareholders and investors. So answer those two questions, sir, if you would.

Mr. SULLIVAN. Thank you, Mr. Larson. That is quite a challenge, for an economist to put something in plain English, but I will try.

[Laughter.]

It is about jobs. And we want domestic job creation. And when we look at our tax system, the major flaw of our tax system is the corporate tax. It has always been a flaw. But for the prior 50 years we have had so much economic growth that we haven’t really—we have been able to endure it.

But now we really can’t afford to have a high corporate tax rate. And so, what we—all roads will lead you to the same conclusion. We need to get the corporate tax beaten down as much as possible, because it repels capital from the domestic economy, which raises productivity, which raises wages, which creates jobs. And so we need to be thinking about different types of proposals.

And so, we want—so the conventional tax reform is about broadening the base and lowering the rates. We don’t really have that option any more. We need to broaden the base. We need to lower the rates without getting rid of domestic—incentives for domestic capital formation. And so we need to look at other sources of revenue.

And I think, you know, it is an education process. At first we thought we could broaden the base and lower the rates, and now we see that it is not possible. We can’t get the rate below 30 percent. We need to get it to, you know, to 20, and we can’t even get it to 30 right now. And so, what I think more and more academics are looking at—on both sides of the aisle, this is not a partisan issue—is where else can we get revenue. How can we collect tax in a more efficient way? Nobody likes to raise taxes on anybody, but where are the best places to look?

And if you look at what is going on around the world, where everybody is—all the other countries are lowering their corporate rate, they are raising their value-added taxes. And we don’t have that option. But also, what they are doing is they are—they have fairly high taxes on their—at the personal level. Ireland has very high personal tax rates. The UK has a 45 percent top individual rate. And all throughout the world you see this conscious decision to lower the corporate rate and replace it with a higher individual rate.

Mr. LARSON. And so how would that—as you were saying in the—how would the proposal work, in terms of shifting responsibility to shareholders and investors? How would that—what kind of revenue would—could that get us toward revenue neutrality?
Could that help make up the base? What is the thinking along those—

Mr. SULLIVAN. Well, the—it is—there are limitations on how
much you can raise the taxes at the shareholder level. You can cer-
taxably get the capital gains rate back up to 28 percent. You could
certainly think about getting the dividend rate back to—at the reg-
ular level. And then we raise a significant amount of revenue that
could be used for lowering the corporate rate.

Mr. LARSON. Thank you. I yield back.

Chairman BOUSTANY. Mr. Kelly.

Mr. KELLY. Thanks, Mr. Chairman, and thank you all for being
here.

I continue, though, to—as I listen to all of you, coming from a
little different world than the world I am existing in right now,
other than really pro-growth tax reform and regulation reform, all
the rest of these things are interesting topics to sit around some
night, have a nice drink and discuss and debate. But the reality of
it is, if you look—let’s just relate it to where we are right now, re-
late it to football. We need to look at what the other guys are doing
in order to win, and adopt those practices. Look at why the other
guys are losing, and then thank them for continuing on that same
path, because it makes your win a lot easier.

And what you each have said is exactly what we all agree on,
and that is tax reform. But not just tax reform, but pro-growth tax
reform, based on the market, the global market that we now com-
pete in. Sometimes I think we are going back to the Dark Ages and
we are having debates about how many angels we can fit on the
head of the pin, instead of how many people we can get back to
work.

In my world, profitable companies pay taxes, working people pay
taxes. That is the key to it. So it takes getting more people back
to work. But you have to have a product on the shelf that competes
with everybody else in the global marketplace. And you have all
talked about it. And it is just kind of mystifying that we are sitting
here, asking you questions like, “How could we possibly fix this?”

What is the problem? The cost of operation. So every good or
service that we do—and I don’t care what it is that you look at—
if we are going to make it harder to go to market, more expensive
to go to market with a product that can’t compete on a price range
with everybody else in the world, we are going to continue to lose.
And to think that somehow, by having you come in here, and bar-
ing your souls to us, or giving us ideas is going to get it done, it
is not.

Please tell me about the difference between what the Irish did—
very charming. Love them, cute as the devil they are, but they
have been picking our pockets for a long time. And they just low-
ered their rate again, because they looked at the world and said,
“Wait a minute. These guys are getting close to us. We have to cut
our rates.” Tell me the difference between what the Irish are able
to do overnight, what Cameron is able to do—quickly—and a pivot
to making it more profitable, and giving you more market share.
What is the difference between those models and our models? Just
real—and I mean real quickly, because I think the answer is pretty
obvious.
Any of you. Ms. Angus, what would you do right now, today? And what are they able to do that we are not able to do?

Mr. SPRAGUE. You know, if I can respond to that——

Mr. KELLY. Sure, Mr. Sprague, please.

Mr. SPRAGUE. You know, the Irish tax policy has been consistent for many years, to hold fast to a low corporate tax rate to make them, as they describe, the most competitive jurisdiction in Europe for inward investment. They have done exactly what Mr. Sullivan did——

Mr. KELLY. Exactly. But how did they do it? What process did they go through to pivot to that position? We have been deliberating for years here. I mean they don't have to sit around and deliberate on it as much, it seems to me. Isn't it a quick response? Isn't it an early conviction made saying, “Listen, in order for us to compete we have to act now, and not continue to talk?”

Mr. NEAL. Will the gentleman yield?

Mr. KELLY. No. I will in a minute, I will in a minute. I know we are both Irishmen. I want to get to this.

[Laughter.]

Because I am telling you, I know what they are doing.

Mr. SPRAGUE. You know, their parliament and their ministry of finance has always been consistent: “This is our international tax policy.”

One thing that I think is worthwhile communicating to you is that Ireland came under huge pressure from the EU several years ago to raise their tax rate because Ireland was successful. Ireland achieved——

Mr. KELLY. Well, of course, yes.

Mr. SPRAGUE [continuing]. Lots of inward investment——

Mr. KELLY. If you want to change the rules, that is the easy way to do away with your competition.

Anybody, please tell me how quickly they were able to respond.

Ms. ANGUS. They have a parliamentary system, and we do not.

Mr. KELLY. Thank you. That is what I am trying to get to. We continue to play ring around the rosy with this, and we know what the answer is, but we keep saying this is something we have to get done, but we just can't do it.

Mr. SULLIVAN. You know, Mr. Cameron in the UK, and the same thing in Ireland, they made conscious decisions to raise their other taxes to pay——

Mr. KELLY. Right. Individuals pay almost 50 percent.

Mr. SULLIVAN. Excuse me?

Mr. KELLY. Individuals pay 50 percent.

Mr. SULLIVAN. Yes.

Mr. KELLY. But keep in mind they used to pay a lower percentage on no wages. They would gladly pay 50 percent on higher wages, because they end up with a net gain in their pocket. That is not hard to figure out.

Mr. SULLIVÁN. When Ireland was devastated by the financial crisis——

Mr. KELLY. Right.

Mr. SULLIVAN [continuing]. They cut government worker salaries by 15 and 20 percent. They raised all of their other taxes, but
they kept the corporate rate at 12.5 percent. And there was no debate about it.

Mr. KELLY. Yes. But my point, Marty, is they were able to act quickly.

Mr. SULLIVAN. Yes.

Mr. KELLY. That is the whole point. The purpose of debate is fine, if the consequences are that you actually get something done. And this is a Forrest Gump moment. There ain't no fixing stupid. Thank you. I yield back.

Mr. NEAL. Mr. Chairman.

Chairman BOUSTANY. Yes.

Mr. NEAL. Just to play up on what Mr. Kelly said, the other thing that they did, they took advantage early on of European Union subsidies for infrastructure. They were way ahead of the rest of Europe. The roadways were done. The Internet was prominent across the island. And there is another lesson for everybody: Everybody on that island is literate. That education is the gold standard of Europe.

Chairman BOUSTANY. Mr. Renacci.

Mr. RENACCI. Thank you, Mr. Chairman. I want to thank the panel. It has been enlightening to listen to you. And I spent a week over in Europe talking with Members that were looking at this BEPS project. And Mr. Neal asked a question which I thought was kind of interesting, because I asked a similar question when I was over there. They are lowering rates. And, as we heard, Mr. Cameron is increasing spending. And the question was how are they going to do that.

Well, the answer that I was told was, ultimately, they are going to get American companies over there, they are going to increase their tax base and their jobs. That gets to Mr. Larson's question about jobs. If they can get American companies over there, and they can increase the number of jobs over there, that is how they are going to raise their tax revenues to pay for their military spending. And that is one of the things that we have to start looking at, is how we can be more competitive.

The corporate tax rate is a piece of our revenue structure. But, of course, we all know the individual tax rate is the majority of our revenue that we get in. And how we fix this system is that we look toward more jobs here. And today, if we continue to do nothing, and more companies go overseas, those companies are going to end up taking our jobs over there, increasing their payroll taxes, and taking the dollars that we should be getting by increasing jobs here.

I was a businessman for 28 years. If I can save 20 percent, I am going to save 20 percent. If I have to pay 20 percent more, I am going to have less employees. It is a pretty simple fact when you work in the business world here in America, that if you can move overseas you are going to do that. So this is something we have to move on. And that is why I appreciate all of your comments.

I want to go back to—I am actually glad that we hit on action 13, because I really think that is important, and the cost to companies to have to provide that. Because that is also a job issue. If I have to spend more money here to comply with action 13, I am going to have less for jobs. So that is one issue.
Mr. Sprague, I noted that at least one company—well, at least one of your member companies—is a target of these state aid investigations. But this is for the entire panel. Does it appear that U.S. companies are being targeted more than the EU companies when it comes to state aid? I don’t know who can answer that, but——

Mr. SPRAGUE. Well, there—of the various companies that have been targeted, only one is a non-American company. We, of course, don’t have information as to how the competition directorate made their decisions, but many commentators have noted the fact that all of the rest of the targets are, indeed, U.S. companies.

Mr. RENACCI. Yes, it is interesting. Because, again, I go back to the fact as—how are European countries going to raise their revenues? It keeps going back to figuring out how—a way to get the American profits taxed overseas. So these are issues that we continue to go back and forth on.

Ms. Angus, in your testimony you said that the BEPS recommendations generally reflect a move away from the relatively clear roles and well-understood standards to less-specific roles, more subjective tests, and vaguer concepts. Can you explain how the vague roles adversely impact American companies, in particular?

Ms. ANGUS. Certainly, I think vague rules are subject to different interpretation in different hands. That is an invitation for double taxation, for more than one country to seek to tax the same dollar of income.

I think there are fundamental ways that the BEPS recommendations have increased vagueness. Maybe one I would single out is the proposed changes to the permanent establishment rules, the rules for setting a threshold for when a country is considered to have taxable—a company is considered to have a taxable presence in a country.

The BEPS recommendation would move away from a relatively clear set of rules to much vaguer standards, so that a company entering into business in a country won’t know when it will cross the line and be considered to be like a domestic company, and subject to the full rules, the full compliance procedures in that country. That adds a huge burden, in terms of the need to fully comply with all aspects of the tax system, to file a tax return as if it was a domestic company.

It also can have implications beyond the income tax. If a company is viewed as having a permanent establishment, it may be required to register for value-added tax. There may be other licensing requirements that get carried with it. And, at the same time, its home country may not believe that there is a permanent establishment there, may not be willing to cede taxing jurisdiction. And so you have double tax.

Mr. RENACCI. Thank you, Mr. Chairman. I yield back.

Chairman BOUSTANY. I thank the gentleman.

Mrs. Noem.

Mrs. NOEM. Thank you, Mr. Chairman.

Ms. Angus, we talked a lot today about U.S. multinationals. We tend to think of them when we are talking about the international tax system. But in all reality, in your testimony you shared that a company doesn’t necessarily have to be large to be impacted. And all global companies are going to face uncertainty with regard to
cross-border operation and investment, in light of the BEPS recommendations.

But could you comment about the impact that the BEPS recommendations and related measures might have on smaller U.S.-based companies? In particular, looking at what they might do in regards to expansion into other countries, and what they might do to expand their presence in—overseas, to market their goods.

Ms. ANGUS. I think the issue with respect to smaller companies is a really important one that we sometimes lose sight of. People think that an international company equates with being a large company. That is not true today. The smallest of companies can operate cross-border. Some might say that the smallest of companies must operate cross-border in today’s global economy. And for them, the uncertainty, the new compliance burdens, the potential for double taxation is particularly stark.

A smaller company doesn’t have the resources to invest in order to put in the infrastructure to produce a country-by-country report, to be able to get the representation to understand the details of the tax rules in every country in which it might be doing some business to try to see will it be considered to have a permanent establishment in that country, and then need to come in to the full compliance net in that country. Those issues really can operate as barriers to that activity if the potential to serve that market could cause the company to suddenly become a full taxpayer in that country, and fully into the system.

The answer might be it is better not to serve that market, and that is a really unfortunate answer, I think, for both the U.S. company and for the potential consumers in that country.

Mrs. NOEM. I think that is why I wanted to highlight your testimony, because most of the discussion here today people would think revolved around very large entities and companies that have multiple opportunities to expand into many different countries. But in reality today, many small businesses, this is such a burdensome change in recommendations that are being made here, that it could completely eliminate their ability to be a part of a market, or even continue to stay in business if a lot of these things are implemented.

So thank you for giving us some more insight into that, because, regardless of the size of the company, this could be very detrimental into the future.

Thank you. I yield back, Mr. Chairman.

Chairman BOUSTANY. I thank you.

Mr. Reed.

Mr. REED. Thank you, Mr. Chairman. I am interested in having a conversation about research and development, and what this BEPS project and tax policy is doing in regards to where R&D is located.

So, Mr. Sprague, I read your testimony and found some of your comments insightful here. For your member corporations or companies, most of their R&D is done where? I think I know the answer to that, but I just want to make sure we are clear on that.

And after the BEPS project, where do you see that impacting, and how does that negatively or positively impact that R&D component of your member companies?
Mr. SPRAGUE. Well, major U.S. multinationals will tend to do R&D in many places around the world. The life cycle of an R&D-intensive company coming from the United States is that R&D will start out being done in the United States. But as the company grows, they will tend to look for excellence elsewhere. Sometimes that is in India. You know, sometimes that is in other places.

The effect of the BEPS process on the choice of location for R&D will be, I think, in two areas. One is for countries that do have an innovation box, they are putting on the table an incentive: Please move your R&D to our country. So every R&D-intensive company will look at that and make a decision as to whether it is worthwhile to move the R&D to the UK, for example, in order to take advantage of that innovation box.

The other incentive is a little more subtle, and that goes to the transfer pricing points. U.S. software companies are, by and large, organized in fairly efficient structures. They generally will have a centralized sales entity somewhere, to try to minimize the footprint and the higher tax market jurisdictions. And a big theme, as I noted in my testimony, of the transfer pricing is the market jurisdictions will try to attract income into the market countries and tax it there, so that counter to that, under the BEPS project, is to move high-value functions—not just R&D, but high-value management functions—into places like Ireland, for example, in order to provide a counterweight to the Germanies and Francies of the market jurisdictions.

So, when thinking about how the BEPS project will influence the decision of companies on where to locate high-value jobs, the R&D part is part of it. But the high-value job generally—not just R&D—is also a part of it.

Mr. REED. So, what is your recommended course, as to try to avert that situation, going forward?

Mr. SPRAGUE. Well, the—

Mr. REED. The Boustany-Neal bill. I heard it over here, but——

[Laughter.]

Mr. SPRAGUE. Yes. No, as I said in the testimony, we think the single best thing is comprehensive international tax reform with a competitive U.S. innovation box to make it more attractive for U.S. companies to keep the R&D here.

Mr. REED. And, obviously, we have had that conversation at length today about the possibility of that occurring. And, you know, we are not very optimistic that is going to happen any time soon.

So there—is there any short-term—I always operated—when I was in private business, I always had a short-term, mid-term, and long-term plan. Obviously, if we could get to tax reform on a comprehensive basis, you know, that is something that I would love to see on a short term horizon. It is highly unlikely, in my opinion, we are going to get there in the next 6 months or thereafter. So is there anything we could be focusing on from the panel to try to stop this loss of high-value, high-functioning R&D activity that you would recommend to us?

Ms. SCHULTZ. You could make the R&D tax credit permanent. That would help a lot. The fact that the credit is short-term, and is always expiring, is really detrimental to long-term planning by
companies. And having that assurance would really be great. If you want to do anything, make the R&D tax credit permanent.

Mr. REED. I appreciate that very much. And I think—hopefully, we can get that taken care of sooner, rather than later. So I appreciate that input.

Is there anything else, Ms. Angus or Mr. Sullivan, in regards to short-term—because I am really concerned about the loss. Once you lose that R&D, once you lose those high-value positions, it is tough to get that back. So do you have any short- or mid-term plans, other than permanency of the R&D tax credit, which I totally appreciate and totally support? Is there anything else anyone could offer for us?

Ms. ANGUS. I think that the permanent R&D credit is certainly important. I think that comments that have been made earlier with respect to the BEPS project, the importance of continuing the work, and now pushing it in the direction of trying to ensure fair, effective, and a transparent tax administration around the world, to counter some of the potential for aggressive interpretations of some of the proposals that would—for example, overreach in the transfer pricing area is a really important thing to continue to work on. None of that, of course, is a substitute for all the work that you all are doing on tax reform.

Mr. REED. I appreciate that, Ms. Angus. And that is the action 13 issue that we talked about earlier with Mr. Stack from the Treasury Department.

With that, I yield back. I notice my time is up.

Chairman BOUSTANY. I thank the gentleman. I thank all of you for your expert testimony. This has been very helpful. We have gleaned a lot of valuable information.

And I'd like to also advise you that Members may submit written questions to be answered in writing. Hopefully you can get back to us within a couple of weeks with that.

With that, the Committee stands adjourned.

[Whereupon, at 12:26 p.m., the Subcommittee was adjourned.]

[Submissions for the Record follow:]
Statement of
Andrew F. Quinlan
President
Center for Freedom and Prosperity

House Committee on Ways & Means
Subcommittee on Tax Policy
Hearing on The OECD Base Erosion and Profit Shifting (BEPS) Project

December 1, 2015
Chairman Boustany, Ranking Member Neal, and Members of the Subcommittee on Tax Policy, thank you for the opportunity to submit written testimony on the OECD's project on Base Erosion and Profit Shifting (BEPS).

My name is Andrew Quinlan. I am the president of the Center for Freedom & Prosperity (CF&P). The primary mission of the Center for Freedom & Prosperity is to defend tax competition as an important principle that helps ensure a prosperous global economy.

The BEPS project poses a direct threat to tax competition and American business. First and foremost, it is necessary to understand that the OECD does not have American interests at heart, nor even the welfare of the global economy. Rather, it is an unaccountable bureaucracy that serves the narrow interests of finance ministers and tax collectors from its rich-nation members.

The OECD has a long documented history of advocating policies against the interests of American taxpayers and businesses, and of abusing its reputation to strong-arm jurisdictions into adopting self-destructive tax policies. The United States must not buckle under pressure to do so in the case of BEPS.

The project on Base Erosion and Profit Shifting has been pushed under a dishonest premise. Despite a relatively small and temporary dip in recent years thanks to the recession, corporate tax revenues as a share of global GDP have trended steadily and decisively upward over the last few decades. The contrary but popular idea of a corporate tax dodging problem is a myth designed to draw attention away from irresponsible budgets and profligate government spending.

In order to avoid scrutiny of the project, BEPS proceeded rapidly from conception to completion. The OECD is now hoping that the world similarly implement its dictates without the careful consideration the subject demands.

It is paramount that Congress prevent the U.S. Treasury from unilaterally fulfilling the OECD's wish to rewrite global tax rules without democratic oversight. In particular, rules designed to enable global fishing expeditions on American businesses through demands for inactive and unnecessary amounts of private and proprietary data should be rejected.

Far from acquiescing to the OECD's scheme, the U.S. should take a leading role in defending the principles of free and open markets, and call on other nations to similarly reject their demands.

For further substantiation of the OECD's motives and more in-depth explanation of the true costs of allowing BEPS to proceed, please consider the additional materials appended to this statement.
Coalition for Tax Competition

July 14, 2015

Dear Senators and Representatives:

The Organisation for Economic Co-operation and Development (OECD) is rapidly working to rewrite global tax rules in the name of combating base erosion and profit shifting (BEPS). We the undersigned organisations are deeply concerned that this process lacks oversight and will result in onerous new reporting requirements and higher taxes on American businesses, and are urging Congress to speak up for U.S. interests by adding its voice to the process.

The OECD has a history of supporting higher tax burdens and larger government, and the BEPS project represents just the latest salvo in a long-running campaign by global bureaucrats to undermine tax competition and its restraining force on political greed.

Because the OECD is populated by tax collectors and finance ministers, new rules being drafted through the BEPS initiative are necessarily going to be skewed in their favor. Businesses are given only a token voice, while other interests are not considered at all. Consumers, employees, and everyone that benefits from global economic growth are not able to make their preferences known.

The inevitable prioritizing of tax collection over every other political or economic interest ensures that the result of the BEPS project will be economic pain. And based on the OECD’s own acknowledgement that corporate tax revenues have not declined in recent years, that pain will provide little to no real gain to national treasuries.

BEPS recommendations already released further show a troubling trend toward excessive and unnecessary demands on taxpayers to supply data not typically relevant to the collection of taxes. This includes proprietary information that is not the business of any government, and for which adequate privacy safeguards are not and likely cannot be provided.

The Treasury Department should not be the only voice representing U.S. interests during this critical process. We urge members of Congress to get involved before it is too late, and to protect American interests by ensuring that the voices of tax collectors are not allowed to speak for everyone.

Sincerely,

Andrew F. Quinlan, President
Center for Freedom & Prosperity

Grover Norquist, President
Americans for Tax Reform

Pete Sepp, President
National Taxpayers Union

Michael A. Needham, CEO
Heritage Action for America

Tom Schatz, President
Council for Citizens Against Government Waste

Seton Motley, President
Less Government

Wayne Brough, Chief Economist and Vice President of Research
FreedomWorks

J. Bradley Jansen, Director Center for Financial Privacy and Human Rights

Phil Kerpen, President
American Commitment

David Williams, President
Taxpayers Protection Alliance
Bob Bauman, Chairman
Sovereign Society Freedom Alliance
Karen Kerrigan, President
Small Business & Entrepreneurship Council
Sabrina Schaeffer, Executive Director
Independent Women's Forum
James L. Martin, Chairman
60 Plus Association
Heather Higgins, President
Independent Women's Voice
George Lundth, President
Frontiers of Freedom
Lew Ullman, President
National Tax Limitation Committee
Terrence Scanlon, President
Capital Research Center
Tom Giovannielli, President
Institute for Policy Innovation
Andrew Langer, President
Institute for Liberty
Eli Lehrer, President
R Street Institute
Chuck Muth, President
Citizen Outreach
BEPS Has Tax Competition in the Crosshairs
Brian Garst, Center for Freedom and Prosperity
Originally published October 2015 by Offshore Investment

The OECD's work on Base Erosion and Profit Shifting (BEPS) is complete; after what can only be described as an extremely rushed process by global policy standards. In an effort to understand the broader implications of the project and what it means for the future of international taxation, I authored a study published June 2015 by the Center for Freedom and Prosperity titled, "Making Sense of BEPS: The Latest OECD Assault on Tax Competition." The following is an abridged version of the paper:

Introduction

Under direction of the G20, the Organization for Economic Cooperation and Development (OECD) began two years ago a major initiative on "base erosion and profit shifting" (BEPS). The project has garnered little interest from U.S. policymakers to date, yet its ever expanding scope and profound implications for the global economy should demand their attention.

In February 2013 the OECD released a report titled, "Addressing Base Erosion and Profit Shifting" (BEPS Report), declaring that, "Base erosion constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for OECD member countries and non-members alike." The OECD followed up with a plan in July 2013, "Action Plan on Base Erosion and Profit Shifting" (Action Plan), that identified 15 specific areas to address.

Through the BEPS project, the OECD is continuing its war against tax competition. Its proposals would enable endless global fishing expeditions and provide cover for governments to choke the economy with new taxes.

The Threat to the Economy

The OECD and other supporters of the BEPS initiative argue that there are economic benefits to preventing tax avoidance techniques. Namely, they contend that activity undertaken in response to tax policy represents a market distortion. In the narrow sense this is accurate, but as a justification for the OECD's current activities it falls short.

Typically ignored in the BEPS discussion are the broader implications of proposed reforms on the political economy. If all differences in tax policy were successfully minimized, to some extent it would indeed reduce profit-shifting aimed at suppressing tax-burden. So too would reducing taxes to zero, but policymakers have a variety of objectives to weigh and ought not elevate ending profit-shifting above all other national interests.

BEPS would lead to an overall higher tax environment as politicians freed from the pressures of global tax competition inevitably raise rates to levels last seen in the early 1980s, when reforms by Reagan and Thatcher sparked a global reduction in corporate tax rates that has continued to this day. Through tax competition, the average corporate tax rate of OECD nations declined from almost 50% in 1981 to 25% in 2015.

Taxes themselves distort the market by shifting resources away from market-driven activities and toward politically driven activities, and higher rates, all else being equal, increase the effect of the distortion. Poorly designed tax systems – the global norm – introduce yet more distortions through the common practice of double taxing capital, which is of particular importance when discussing BEPS given that corporate taxes are often identified as the most destructive form of capital taxation, as even OECD affiliated economists have acknowledged.

Governments necessarily need taxes to fund essential functions, but ideally should seek to minimize the economic footprint of taxation as much as possible. Political incentives, however, often work in opposition of this goal. Politicians face pressure to demonstrate to constituents that they are performing and to please the interests that support their campaigns, and that in turn encourages taxes to rise above and beyond the level of optimum growth, or where new spending no longer provides net economic benefits.

Tax competition thus provides one of the main sources of push-back against the drive to spend and tax.

Tax collectors and finance ministers have mandate say in the activities of the OECD, so it's expected that the BEPS initiative would represent their views above all else. The Action Plan thus considers the benefits of tax competition to be the real problem, explaining that "there is a reduction of the overall tax paid by all parties involved as a whole." The prospect of there being less money to be spent by politicians is perceived as a problem to be solved, rather than as a positive for the global economy.
The Threat to Privacy

Several BEPS action items raise serious privacy concerns. Proposed recommendations for transfer-pricing documentation and country-by-country reporting, for instance, feature broad reporting requirements that go far beyond what is required for purposes of immediate tax assessment.

Guidance for Action 13 recommends a three-tiered approach to transfer-pricing documentation consisting of a master file, a local file, and a country-by-country (CbC) report. Information contained in the local and master files are particularly vulnerable, since it would take a breach in only a single jurisdiction for it to be exposed. The OECD makes assurances for the confidentiality of these reports, but they are empty promises. Such government assurances of privacy protection are contradicted by experience and the long history of leaks of taxpayer information. In the United States alone tax data has frequently been exposed thanks to inadequate safeguards, or even released by officials to attack political opponents.

Even without malicious intent, governments are ill equipped to protect sensitive information from outsiders access. According to the U.S. Treasury Inspector General for Tax Administration, 1.6 million American taxpayers were victimized by identity theft in the first half of 2014, up from just 271,000 in 2010. Chinese hackers were blamed for a breach that exposed data of four million current and future declared employees, and the massive new collection effort and reporting system being established to enforce the Foreign Account Tax Compliance Act has also been faulted for its insufficient privacy safeguards.

As poor as the United States has proven at protecting privacy, there are likely to be nations even more vulnerable. Through the master file and other reporting mechanisms, BEPS will demand of corporations proprietary information and other sensitive data that they have every right to keep private and out of the hands of competitors. When it takes a breach of only a single national government to expose this information, there will no longer be such expectation of privacy.

Is BEPS a Serious Problem?

The OECD’s website describes BEPS as “tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low or no-tax locations where there is little or no economic activity, resulting in little or no overall corporate tax being paid.” The BEPS Report further claims that, “it may be difficult for any single country, acting alone, to fully address the issue.” Or as the website more succinctly describes, BEPS “is a global problem which requires global solutions.”

No significant evidence for these assertions is provided, however. The OECD’s BEPS Report itself underestimates the argument that there is a pressing need for a global response when it acknowledges that “revenues from corporate income taxes as a share of GDP have increased over time.”

Academic research on the impact of BEPS is far less certain than the rhetoric of the OECD and the OECD. The strongest analysis yet to date comes from Dhanmala Dhanapala, whose survey of the literature reports that recent studies tend to find lower levels of shifting than earlier work. It also challenged arguments that point to the fraction of the income of MNCs that is reported in tax havens to various sources as evidence of double taxation. It is, in fact, the only measure that even the most charitable of the OECD’s reports recognize as evidence of a real BEPS problem. It should be expected to see more money being earned where tax policy is less hostile.

Part of the reason there exists little evidence of a significant global BEPS problem is that domestic policy solutions are already available to address legitimate areas of concern when they arise. More importantly, the best solution available for preventing base erosion is the adoption of a competitive tax code. Pro-growth tax policy that eschews double and worldwide taxation not only won’t cause capital flight, but will attract investment instead.

Broader Aims of the OECD

To fully understand the significance of the BEPS effort, it is necessary to place the current agenda within the broader context of the OECD’s work in recent decades. In 1988 the OECD declared war on tax competition with a report entitled, “Harmful Tax Competition: An Emerging Global Issue.” Its authors warned that, among other things, tax competition “may hamper the application of progressive tax rates and the achievement of redistributive goals.”

The organization was eventually forced by political opposition to back away from explicit condemnations of all tax competition, but has not abandoned its views. Rather, it has adopted new tactics toward the same end. To make this point clear, the Action Plan thoroughly references Harmful Tax Competition as justification for its recommendations. It also repeats a popular but baseless theory among left-wing academics and politicians about tax competition—that it
promotes a 'race to the bottom.'

The race to the bottom the theory, then the high-tax countries would force zero rates on mobile capital. It hasn't happened. One review of common such claims finds: 'there can be little doubt that history has proven wrong the prediction of a complete erosion of capital tax revenue. Comparative data on corporate and capital tax rates demonstrate that governments in all countries continue to tax mobile sources of capital, effective capital tax rates have not changed much compared with the mid-1980s, when tax competition was triggered by the 1986 US tax act, and tax systems are as varied as countries and political systems themselves, with no sign of converging.'

Nevertheless, the BEPS report notes: 'In 1998, the OECD issued a report on harmful tax practices in part based on the recognition that a race to the bottom would ultimately drive applicable tax rates on certain mobile sources of income to zero for all countries, whether or not this was the tax policy a country wished to pursue.' Reality, essentially, is an unwarranted intrusion on the desire of policymakers to set without consequence. The BEPS report goes on: 'It was felt that collectively agreeing on a set of common rules may in fact help countries to make their sovereign tax policy choices.' Unless, that is, their sovereign choice involves something other than raising taxes.

Nations that opt for little or no taxes on capital are a problem for this quasistatic theory of sovereignty -- where the rest of the world must be brought to heel in order to ensure that policymakers ought not to consider the economic consequences of their policies -- hence why the primary indicator for determining whether a nation is to be identified as "potentially harmful" is that it has "no or low effective tax rates."

Other factors are said to be considered, but without clear indication of how they are to be weighted any calculation will be arbitrary and open to excessive emphasis on the "gateway criterion" that is a low tax rate. When a low-tax source is identified, the OECD benevolently provides that, "the relevant country will be given the opportunity to abolish the regime or remove the features that create the harmful effect." To make perfectly clear that this is the sort of offer a nation cannot refuse, they warn: "Where this is not done, other countries may then decide to implement defensive measures to counteract the effects of the harmful regime, while at the same time continuing to encourage the country applying the regime to modify or remove it."

The OECD's previous aggressions against low-tax jurisdictions in pursuit of its quest to abolish tax competition make clear just what "defensive measures" it has in mind, and how its members will go about trying to "encourage" compliance. In the years that followed release of Harmful Tax Competition, the OECD used threats of blackmail, peer pressure, and intimidation to enlobe low-tax jurisdictions into adopting various policies presented under the auspices of increasing tax transparency and combating evasion. In practice the changes were intended to undermine the attractiveness of low-tax jurisdictions and protect high-tax nations from base erosion due to capital flight.

Of particular relevance for understanding the BEPS initiative is the pattern demonstrated by the OECD during the course of this campaign. After each recommendation was widely adopted -- typically under threat in the case of low-tax jurisdictions -- the OECD immediately pushed a new requirement that was more radical and invasive than the last.

The fact that the OECD is always ready with a new policy after one is implemented suggests that the organization's goal is not merely what is stated, or that it is merely off-target. In either case it should serve as a blow to its credibility and a reason to question its work on BEPS.

Conclusion

Were the OECD merely a research institution, its work could be dismissed simply as a bad idea that no nation need adopt. Unfortunately, Europe's dominant welfare states use the OECD's work as a benchmark when coercing other nations through use of political and economic leverage. For the low-tax jurisdictions, and now multinational businesses, caught in the OECD's crosshairs, the race only ever ends. The BEPS project is a continuation of the OECD's well-documented effort to eliminate tax competition, and will likely follow the same pattern of consistently moving goadposts.

The BEPS project has been a success of a tiny few, without open and public debate regarding the assumptions motivating the effort, its goals, or the most appropriate methods to achieve them. There is a lack of accountability, reflected in the activities of the BEPS initiative, that can only be rectified through open public debate and direct political oversight.

END NOTES:

BIAC has been supportive of the OECD’s Base Erosion and Profit Shifting (“BEPS”) project since its inception and has provided constructive and detailed input from the international business community in response to all discussion drafts. Although we value the openness of the consultation processes and acknowledge the efforts of OECD and G20 member governments and the OECD Secretariat, we are anxious that some serious business concerns have not been sufficiently considered or addressed.

At the March 2015 meeting of the BIAC Tax Committee, a substantial number of member organizations expressed concerns over the direction of certain aspects of the BEPS project, and the potential significant negative economic consequences of several Action Items, and it was agreed to set those out in a short document. This document has been updated following the release of the OECD’s final reports in October 2015. We would reiterate, despite the concerns noted below, that we want the BEPS project to succeed. We will continue to approach this project—both before and after the adoption of the recommendations by the G20—in a constructive, flexible and incremental way as we believe this is the best way of achieving that success. We call on the OECD to continue to include us in the completion of outstanding work, and the development and implementation of the G20 proposed framework for implementation.

General comments

Many of the concerns identified in this Position Paper are common across the range of Action Items. We feel they are worth repeating up front as their importance continues to grow as the follow-up and implementation work commences.

Economic impact: There is great concern that the economic consequences of the recommendations have not yet been fully considered. Countries should be undertaking realistic assessments of the tax revenues they may be due under the consensus reached, rather than assuming that implementation will bring additional tax revenues. The possibility should be understood that overly strict regulation could force economic activity out of countries. Countries should not rush to implement proposals with such aims in mind when the actual impact on their tax revenues has not been determined—this could undermine the BEPS process and bring about unintended economic implications. Although uncertainty, double-taxation, disputes and compliance burdens are a focus of business, we are also concerned about the broader economic impact, which may include, for example, the impact on the efficiency of markets, or the sustainability of certain legitimate non-tax driven commercial transactions and structures (for example, cross-border infrastructure projects or regionalisation of certain functions to improve quality and efficiency). We believe that the justified targeting
of BEPS activities must be integrated with larger economic concerns related to creating jobs and growth through cross-border trade and investment.

Complexity & Compliance: In a number of areas, the BEPS Action Plan proposes substantially new and complex rules to tackle avoidance. Given the pressures of the ambitious timeframe, there have been very few opportunities to explore how these complex proposals can be adopted and implemented on an international basis. Both tax authorities and businesses will need detailed implementing guidance to ensure that the intention of each recommendation is clear. This will be critically important in ensuring that the recommendations are uniformly adopted, whilst avoiding overlaps. The challenges that will be brought about through the interaction of different timelines and domestic implementations should not be underestimated. They could lead to double taxation and a significant compliance burden on both businesses and tax authorities and create uncertainty that will delay necessary investments. We look forward to the OECD’s development of an inclusive framework to support and monitor the implementation (as proposed by the G20 Finance Ministers) to assist in maintaining international co-operation and as much consistency in timing and application as is possible. We would encourage the OECD to seek agreement from involved countries on effective dates for which new rules and guidelines will apply; even with the OECD’s work on Action 14, it will be very difficult to eliminate double taxation and would be inequitable if some tax authorities seek to revisit past years with new concepts and methodologies.

Scoping: As part of the implementation framework, we believe it would be helpful to target the scope of each recommendation more narrowly to increase the chance of developing the necessary inter-governmental co-operation. At present, many proposals appear to go beyond the scope required to effectively target BEPS related activities. We strongly believe that “success” in the BEPS project would be achieved with a set of detailed, well-defined proposals that can be (and are) implemented consistently. Countries should be encouraged to avoid overly-broad implementation that could lead to a less uniform international tax regime.

Timing: As well as the timing concerns raised above in relation to the potential economic impact and the potentially disjointed international adoption of the recommendations, we also have a more general timing concern that impatient countries and tax authorities may seek to commence full implementation of recommendations where it has been agreed that further work is required. For example, critically important work remains in relation to profit attribution to permanent establishments and specific rules in relation to financial services and insurance businesses.

Reaching consensus

BIAC has strongly supported the OECD as the best organisation to deliver a successful consensus outcome under the BEPS mandate and recognises the phenomenal work that the OECD has done in brokering compromises and consensus wherever it has been possible. However, despite the OECD’s claims, we are concerned that many instances it has proved difficult (and occasionally impossible) for member governments to reach consensus. This has resulted in a lack of clarity and a degree of ambiguity. For example, whilst the OECD has not recommended solutions regarding the “digital economy”, the door has been left open for countries to implement solutions unilaterally which, if implemented, could lead to double taxation.

Understanding the economic impact

It remains a matter of some regret that, owing to the political nature of the timetable, the BEPS project could not begin with a detailed economic analysis of the abuses identified in the Action Plan, including the scale and importance of “double non-taxation” and “tax competition”. We are concerned that the public announcements and discourse have been optimistic in terms of the amounts of additional tax that will be collected as a result of the BEPS recommendations, due in part to the conclusions reached in Action 11, and strengthened by the impression that the expectation of additional tax receipts was in some way a prerequisite of reaching a broad consensus. Whilst we understand the public and political pressure surrounding
the project elevated a need for consensus in agreeing that businesses should be taxed on all profits, most countries who have offered a public opinion on the matter seem to have assumed that the implementation of the proposals will increase their tax revenues substantially.

In reality, depending on which of the proposals are introduced by themselves and/or other countries, there could be many countries that do not receive additional tax revenues. There may be cases where overly strict regulation pushes economic activity out of some countries. If not dealt with by rigorous impact assessments both at international and domestic levels, we are concerned that this expectations gap could lead to countries budgeting for higher tax revenues than they will receive. The resulting pressure could end in countries opting not to implement all of the proposals uniformly, an outcome that would result in double taxation and more pressure on individual tax authorities to aggressively audit taxpayers in an attempt to collect more tax rather than the right amount of tax based on the consensus agreed. A failure of the BEPS project in such a manner is not in the interests of business, governments or the public and will significantly increase the costs of tax administration and tax compliance.

Complexity and compliance burden

The BEPS recommendations are likely to create significant implementation difficulties and greater compliance burdens, not only for Multinational Enterprises (MNEs), but also governments - this is in part due to the substantial number of recommendations, but also their complexity and the different timelines that will need to be followed to implement them (for example, the adoption of revised OECD Guidelines into domestic law, or different processes for implementing domestic recommendations). Public and considered consultation and strong commitment by countries to work together (supported by the OECD’s implementation framework to be developed in 2016) are essential to avoid fragmentation.

We would encourage the OECD to seek agreement from involved countries on effective dates after which new rules and guidelines will apply; even if the OECD’s work on Action 14 is successful in improving dispute resolution, it will be very difficult to eliminate double taxation and would be inequitable if some tax authorities seek to revisit past years with new concepts and methodologies.

We support the OECD’s statement that VAT registrations should not create PEs, and we would encourage tax administrations to heed this and not assume that PEs exist where a company is registered for VAT (or vice versa), which would result in significant compliance burden. Other Action Items (for example, Actions 2, 3, 4, 7 and 12) are also likely to require significant additional resource to ensure compliance with new, complex and sometimes contradictory rules.

Discouragement of related party trade

Many of the BEPS Action Items apply only in an intra-group context and could significantly increase the cost of performing various functions or undertaking certain transactions inside a group of related companies. For example, the recommendations to lower the PE threshold and the complex new transfer pricing analyses that only apply to transactions between affiliates could greatly increase the compliance cost and tax liabilities associated with various intra-group activities. In some cases, taxpayers may, effectively, be forced to conduct business with third parties to mitigate excessive tax cost or uncertainty. This would reduce commercial and economic efficiencies and hamper international trade (as well as, quite possibly, lowering the wages and benefits in outsourced functions - especially in developing countries). We believe that these effects should be considered in greater detail and encourage additional guidance to be developed to provide greater certainty.

Appropriate resources for tax administrations

Tax administrations already receive significant amounts of information that they often struggle to process. We are concerned that without additional resources, tax administrations will face difficulties in effectively using additional information and in dealing with the expected increase in requests for exchange of tax
information between countries. It may actually become more difficult to identify risks, or to target abuse, to the advantage only of the most aggressive taxpayers.

We believe a greater focus on tax administration would be beneficial—for example, through fully integrating the work of the Forum on Tax Administration—and the use of targeted risk-based measures. This could include materiality thresholds and other risk-identification tools to target higher risk taxpayers/issuers that represent the most substantial sums of lost tax revenues. Such approaches reduce the burden on the vast majority of compliant taxpayers, freeing up resources for more productive, value-creating activities. Cooperative compliance also has an important role to play in this area.

**Multilateral implementation**

The ultimate success of the BEPS project will be the multilateral implementation of specific, measurable, achievable and realistic recommendations on a timely basis. Whilst much work on implementation mechanisms is still to come throughout 2016; we encourage early discussions on approaches to enhance credibility and likely success of the project. We make the following recommendations in this regard:

- The G20 proposed engagement framework should be prepared and managed by the OECD Secretariat;
- As a first step, all countries should agree to key principles to be followed in any domestic legislation used to enact BEPS proposals. Such principles could include that:
  - the policy objective should be clearly stated;
  - the policy objective should be consistent with the BEPS recommendation, and in particular, should be limited to addressing specific abuses;
  - draft legislation should be prospective in application and be published with a minimum period for detailed stakeholder consultation; and
  - an impact assessment should be prepared to evaluate any compliance burdens created.
- We encourage the OECD to coordinate the implementation so that national measures have a reasonable degree of consistency.

**BEPS Action Item-specific comments**

**Address the tax challenges of the digital economy (Action 1)**

We greatly welcomed the original 2014 report (Addressing the Tax Challenges of the Digital Economy), but we consider that the final 2015 report does not go far enough by recommending only that such countries are mindful of their treaty obligations until further review in 2020. There is concern amongst BIAC members that some countries are considering withholding taxes on digital transactions, and whilst the final report recognises that this is not recommended, it neither discourages such action nor identifies the treaty obligations and implications that such taxes could breach. Such unilateral action will certainly result in double or even multiple-taxation unless there is a very clear and strong consensus as to how the profits of digital business transactions should be taxed. BIAC looks forward to participating in ongoing monitoring and evaluation characteristics of digital trade that may cause BEPS concerns.

**Neutralizing the effects of hybrid mismatch arrangements (Action 2)**

While we do not defend hybrid mismatches as a general policy matter, we do want to make three important points on the final report:

- It is not clear which countries intend to implement any or all of the recommendations, when they plan to do so, or how the interaction with the local legislation processes will result in differences between countries in terms of application or timing. Implementation through a combination of complex changes to domestic laws, bilateral treaty provisions and potentially a multilateral instrument increases the uncertainty on timing further. We welcome the development of an inclusive monitoring framework in early 2016 to assist international cooperation but retain concerns...
In particular regarding the risk of double taxation, increased compliance burden and uncertainty that will arise from countries implementing at different times.

- Even if implemented in a coordinated manner, the complexity of the proposed rules will create substantial compliance difficulties, and will complicate the allocation of taxing rights between jurisdictions, increasing the risk of double taxation (e.g., the rules on "imported mismatches"). The accompanying expanded examples may provide clarity on some issues, but at the price of still further complexity.
- The financial services industry continues to be concerned that insufficient attention has been given to how the proposals will impact instruments deemed important by banking regulatory authorities for systemic liquidity. By relying on countries to opt not to tax such transactions at their discretion increases uncertainty and the risk of double taxation.

Strengthen CFC rules (Action 3)
The broad nature of the OECD's final CFC proposals illustrate the difficulty in reaching a consensus position on even the basic purpose of rules, with clear disagreements between governments over whether such rules should tackle profit shifting from the parent entity or foreign-to-foreign abuse. Without clear agreement over the underlying principles, the chances of delivering clear, proportionate and practical solutions were almost impossible. This was an opportunity missed to refine a useful tool, based on well-understood concepts of "active" and "passive" income in ways that could reduce dependence on subjective, fact-intensive enquiries while at the same time limiting the compliance burden and risk of double taxation. We urge the OECD to consider CFC rules further when addressing any future BEPS concerns that the monitoring and analysis highlight.

Limiting base erosion via interest deductions & other financial payments (Action 4)
The final report on Action Item 4 will have serious implications for groups' economic activity and their ability to obtain tax deductions for funding costs. The proposals have been made without a clear articulation of how they specifically target BEPS activities. The OECD's proposals are likely to restrict interest deductions for a significant number of non-aggressive taxpayers, particularly those investing in infrastructure or long-term projects where it remains unclear whether they would qualify for the proposed exemptions. The lack of support for the arm's length principle in Action Item 4 also undermines legitimate commercial reasons for having intercompany debt. A group's cash position and decisions on how to deploy cash should not be limited by rules that are not based on the arm's length principle.

However, given the options previously put forward in discussion drafts, we do welcome the broadening of the corridor approach to a range between 10% and 30% of EBITDA and the relative simplicity it brings. However, this approach could have serious consequences if detailed work is not undertaken to determine appropriate ratios, taking into account the funding requirements of different industries. Where ratios are set too low, this could substantially raise the cost of capital for low-risk taxpayers undertaking commercial transactions. We are disappointed that the proposals do not recommend more strongly the elements of the proposals that would seek to limit double taxation, such as the ability to carry forward unutilised interest capacity (especially for start-ups and companies in loss-making positions) or give credit for all withholding taxes suffered.

Additionally, we note that interest is the "raw material" for financial services businesses. Although a "net interest" approach is endorsed, it is important that the outstanding questions facing the financial services industry be resolved, particularly so that proposals do not contradict the regulatory agenda.

Whilst we welcome the attention that the OECD plans to give to the group wide ratio rules, financial services and insurance industries 2016, we have serious concerns that so much work remains outstanding in this area at a time when countries are otherwise being encouraged to start implementing the rules.
Prevent treaty abuse (Action 6)

We are concerned that significant uncertainty remains as to whether treaty relief is available in ordinary commercial circumstances. This uncertainty risks undermining the usefulness of treaty networks in facilitating trade and promoting economic growth. Whilst we recognise that tax administrations require assurance that treaty benefits are only being granted in appropriate circumstances, anti-abuse rules should be applied in a proportionate and targeted manner. The existing provisions and Guidance could provide more clarity (e.g. low taxed branches with substance, calculation of head office tax rate). Broad disapplication of treaty benefits could create substantial withholding tax burdens and negatively impact cross-border trade.

The final proposed minimum treaty standards are at the very least expected to create a significant compliance burden for taxpayers (especially where both a simplified LOB and a PPT rule are adopted in certain treaties), and will potentially bring into scope legitimate structures that ought to be entitled to treaty benefits. We remain concerned that:

- Structures not involving treaty shopping may be unintentionally caught by broad rules.
- There will be increased cross-border investor uncertainty, especially for pension fund investors and sovereign wealth funds, where the potential for tax treaty abuse is low.
- Uncertainty for Collective Investment Vehicles (CIVs) will be unavoidable, and the time taken to receive repayments of tax deducted at source will impact the Net Asset Values of funds.
- Source country tax authorities may experience additional demands to process an increased volume of claims, placing further pressure on already resource constrained administrations.

Whilst we recognise that the OECD has further work to do regarding the commentary on LOB rules and the impact on non-CIVs and pension funds and welcome the OECD’s commitment to consult on such matters, we remain concerned that the in order forth is to be taken into account as a meaningful component of the multilateral instrument negotiations, this work must be completed swiftly.

Preventing the artificial avoidance of PE status (Action 7)

Whilst many of our members welcome the move away from the ambiguous language of the discussion draft that sought to establish a PE where persons “negotiated the material elements of contracts”, we are concerned that the final deliverables introduce new concepts that were not open to consultation and so retain ambiguity. Whilst we welcome the move to recommendations that a dependent agent PE is only established where a person “plays the principal role” in negotiating contracts, we urge the OECD to undertake additional consultation and provide tax authorities with additional guidance to clarify the meaning further. Similarly, the meanings of “complementary functions that are part of a cohesive business operation” in relation to fragmentation and “at the disposal of” regarding fixed places of business should be more tightly defined to ensure consistency in implementation.

It is disappointing that recommendations regarding PE thresholds have been released before the guidance that will follow on profit attribution. We are concerned that tax authorities will seek to establish the existence of PEs based on new concepts before providing business with any certainty regarding the attribution of profits to these newly defined PEs. For instance, the example of a PE being triggered by an agent who convinces customers to accept standard contracts without any authority to make deviations is very different to the previous definitions. Additionally, we would welcome the confirmation that PEs can be loss making.

It is more disappointing still that the changes required to the OECD Model Treaty, OECD Guidance and domestic/multilateral implementation thereof will undoubtedly be disjointed, and we fear that some tax authorities may seek to apply the new concepts to open periods, which will cause considerable uncertainty and double taxation to arise. We urge the OECD to consider the impact of this as part of the implementation framework being developed and wait until there is a consistent understanding of the concepts before updating the Model Treaty and Guidance.
Transfer pricing (Actions 8-10)

We have consistently acknowledged the need to update international tax rules on Transfer Pricing (TP), especially in relation to intangibles. However, aspects of BEPS project illustrate fundamental differences in opinions between countries over the Arm’s Length Principle (ALP) in TP and its continued viability. We are hesitant in agreeing with the OECD that the final report’s recommendations have been finalised without a departure from the ALP.

We welcome the confirmation that where clear contractual arrangements exist that are supported by economic reality, then recharacterisation is not generally required. However, we are concerned about the complexity of the process, the level of detail required, and the consequences it will entail in the practical application. For example, the modifications do not clearly address the relevance of or extent to which (control and) performance of DEMPE functions and risk should contribute to calculating price under the ALP. These are not generally factors that are taken into account by unrelated parties. We welcome the reiteration that the most appropriate TP methodology should be used, and the OECD’s commitment to developing guidance on profit split methodologies. However, we note that with this work expected to remain incomplete until 2017, a significant period of uncertainty remains, which will cause considerable uncertainty and double taxation to arise. We urge the OECD to consider the impact of this as part of the implementation framework being developed and prioritise these areas accordingly.

We welcome the confirmation that tax authorities should only be permitted to consider ex post outcomes as presumptive evidence about the appropriateness of the ex ante pricing arrangements where taxpayers cannot demonstrate that the uncertainty was appropriately measured in the pricing methodology adopted. However, the distinction between foreseen and unforeseen is subjective and very difficult to make. Additionally, there are many areas of the report that appear ambiguous which will allow countries to take divergent positions. We believe that there remains a significant risk of divergence in interpretation and extent of these approaches, and ultimately of tax authorities using hindsight to recharacterise non-abusive transactions.

Whilst we would welcome the simplicity that the elective regime for Cost Contribution Arrangements (CCAs) could provide, without a commitment from a significant number of countries to implement such a regime it remains the case that businesses will still face a significant compliance burden in satisfying the countries that do not implement it. If a significant number of countries could be encouraged to implement the elective regime at least in part (e.g. service CCAs) this would address these concerns in some cases.

Financial services institutions face regulatory pressures that differentiate them from groups operating in other sectors. The OECD’s 2010 report on the attribution of profits to PEs remains relevant for the taxation of this sector. BIAC cautions against special measures or general principles that move away from this well-established approach.

BEPS Data (Action 11)

Whilst the business community generally agrees that insufficient data is available and that such data would be useful (and are thus supportive of the initiative), there has been little engagement with business in this area. We would welcome the opportunity to assist the OECD in its further work on identifying and analysing data on BEPS.

Re-examine transfer pricing documentation (Action 13)

BIAC fully supports the recognition under Action 13 of the importance of protecting the confidentiality of commercially sensitive information. This protection should apply across all three pillars of TP documentation. We consider it would be a useful addition (perhaps under the framework to be developed in 2016) if peer review mechanisms could be developed to monitor jurisdictions’ adherence to appropriate confidentiality standards, and to ensure that the OECD’s proposals are uniformly adopted.
The Action 13 recommendations will create substantial burdens for business, and effective compliance will require much preparation. For example, there remains ambiguity around areas such as the practicalities of reporting Master Files on a business line basis whilst maintaining a global overview, and many countries are already seeking to implement the country-by-country reporting elements recommendations before the guidance and XML schema are even released. Without further guidance, much of the necessary preparation is impossible. Such implementing guidance should, where possible, leverage data reported under similar regimes (for example the EU’s CRD IV for banking organisations) to streamline the compliance burden for as many taxpayers as possible. Only uniform TP documentation rules across countries will limit the resulting increase in compliance costs for companies, and we urge the OECD to encourage consistency in this area.

Make dispute resolution mechanisms more effective (Action 14)

We congratulate the OECD on the significant steps forward that have been taken in its work on Mutual Agreement Procedure (MAP). The recommended minimum standards on MAP and peer reviews is a welcomed development in the final report. We welcome the OECD FTA’s MAP Forum as the best place for peer reviews to be undertaken, and encourage the OECD and governments to commit appropriate resource to ensure that the minimum standards can be upheld. The full picture of the success of the minimum standards on MAP (and the success of the BEPS Project as a whole) cannot be judged with reference only to tax authorities’ data; we would welcome the opportunity to also be consulted as part of the OECD’s monitoring framework.

We also congratulate the OECD on securing the commitment of 20 countries to binding arbitration and we urge the OECD to allocate necessary resource to ensuring this area is successful. We hope that this will demonstrate to non-participating countries the benefits of such a process to its participants and hope that this will become an international standard that other countries are compelled to join.

Multilateral Instrument (Action 15)

We congratulate the OECD on securing the commitment of c.90 countries to participate in the development of this ambitious project in 2016. We recognise the benefits that could arise from a significant number of countries signing up to the instrument in order to swiftly and uniformly implement the OECD’s proposals.

Whilst the detailed timeline and consultation requirements have not been made public; we hope that the OECD will seek to consult widely and take up BIAC’s offer of support in its work on development of the Multilateral Instrument.
December 15, 2015

The Honorable Charles Boustany
Chairman
Subcommittee on Tax Policy
House Ways and Means Committee

The Honorable Richard Neal
Ranking Member
Subcommittee on Tax Policy
House Ways and Means Committee

Dear Chairman Boustany and Ranking Member Neal:

The MPAA and its member companies are grateful to you and your staffs for your efforts to reform the U.S. tax system. We very much appreciate the Subcommittee’s recent hearing regarding the OECD BEPS recommendations and the potential effects on U.S. companies. We also are grateful for your collective efforts to develop an “innovation box” regime that encourages film and other IP development in the United States.

In that regard, we would like to submit the following comments for the record focused primarily on BEPS Action 5 and the need for the U.S. to adopt an innovation box to respond to actions being taken overseas. This is essential to encourage domestic innovation and development, to preserve and create well-paying U.S. jobs, and to generate economic growth in an increasingly competitive global marketplace.

Introduction

The MPAA’s six members—Walt Disney Studios Motion Pictures, Paramount Pictures Corporation, Sony Pictures Entertainment, Inc., Twentieth Century Fox Film Corporation, Universal City Studios LLC, and Warner Bros. Entertainment Inc.—produce, distribute and export theatrical motion pictures, television programming, and home video entertainment. The studios typically license their IP directly, or indirectly through subsidiaries, to unrelated parties for distribution in U.S. and foreign markets. In exchange, they receive royalties that historically have been subject to tax in the United States.

The motion picture and television industry is an important productive component of the U.S. economy. The industry employed directly or indirectly nearly 2 million people in the United States in 2013 and generated $113 billion in wages. Core production, marketing, manufacturing, and distribution jobs paid an average of $84,000, which is nearly 70 percent higher than the national average. The industry is comprised of a nationwide network of tens of thousands small businesses across all 50 states, with 85 percent of these businesses employing fewer than 10 people. The industry also supports good jobs and wages in thousands of companies with which it does business, such as caterers, hotels, equipment rental facilities, lumber and hardware suppliers, transportation
vendors, and many others. Finally, the industry creates one of our country’s most successful products, garnering a positive balance of trade with virtually every country to which we export and generating an overall $13.4 billion trade surplus in 2013.

**Background – BEPS Action 5**

Several countries have introduced favorable tax regimes for income that is derived from ownership of intellectual property. These “IP Box” regimes were enacted with the aim of attracting foreign investment and ownership of IP in the applicable country. Prior to BEPS and Action 5, such regimes generally have not required work related to the IP be carried out within the country in order to be eligible for IP box benefits. Thus, the tax benefit is currently not dependent on economic activity and innovation taking place in the jurisdiction.

Several other OECD countries had raised concerns that these types of regimes are “harmful” and artificially shift IP ownership and taxable profits away from the country or countries where the value of the IP is created. To address these concerns, the OECD released its final report on Action 5 “Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance” in early October. Under the final report, to avoid being labeled as “harmful,” a preferential regime generally must require substantial economic activity occur within the country for a taxpayer to be eligible for IP box benefits. Specifically, Action 5 proposes that there must be a nexus between the income receiving the benefits and the expenses contributing to that income. Put another way, IP income will only qualify under this “nexus approach” for the preferential rates under an innovation box regime to the extent that the IP development expenses are incurred in the relevant country. Consequently, companies wishing to take advantage of the preferential regimes will need to shift at least a portion of their IP development (and associated jobs) overseas.

**International Tax Reform and the Need to Adopt an Innovation Box**

We believe one of the most important elements of tax reform will be to modernize our international tax system in order to put American companies on a level playing field when competing in the global market place. The current U.S. worldwide system is an outlier among major developed countries with its high statutory rates and the imposition of a residual U.S. tax on foreign earnings. This has a number of adverse economic consequences, causing our companies to be less competitive overseas, encouraging foreign ownership of IP, and locking out cash that could be used for domestic investment. Consequently, we agree with Chairman Brady’s recent statement that we need to quickly conclude discussion on “international tax reform and an innovation box. It could be a significant down payment on overall tax reform, done right, allowing U.S. companies to bring those stranded profits home to reinvest in the U.S. and ensuring America isn’t isolated on the innovation side of the economy.”

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In addition to adopting lower statutory rates and a dividend exemption system, the U.S. needs to take specific steps to respond to BEPS and other developments overseas that, if left unanswered, will result in significant U.S. job and revenue loss. As noted above, other countries are aggressively seeking to attract IP creation and commercialization through the introduction of broad IP regimes and other incentives. In addition, with respect to films, many of our major trading partners (e.g., Australia, Canada, France and the United Kingdom) offer significant wage credits and other above-the-line incentives to attract film productions and jobs abroad, in addition to their lower statutory rates. For example, recognizing the benefits of film production to its economy, the United Kingdom this year sweetened its film and television production incentives by increasing its refundable tax credit from 20% to 25% for all qualifying U.K. film expenditure.

As described above, the nexus requirement under BEPS Action 5 will likely require companies to shift IP development and jobs overseas in order to take advantage of innovation box incentives. Because companies like ours are facing increased pressure from stakeholders to take advantage of these incentives, many will decide to locate IP ownership and a higher proportion of IP development functions overseas to establish the requisite "nexus" to claim such benefits or to justify a higher allocation of income attributable to that IP. This will cause U.S. tax revenues to shrink as the U.S. tax base attributable to IP decreases and credits for foreign taxes paid on IP developed and owned overseas increase.

To prevent greater migration of IP ownership and quality jobs to other developed countries, and loss of the associated tax revenue, we believe the U.S. needs to respond quickly by adopting an IP box that encourages the development, ownership and commercialization of film and other IP in the United States. Consequently, we want to commend and thank both of you and your staffs for the efforts to develop an innovation box proposal to counteract BEPS and other actions overseas, and help ensure that IP development and the associated well-paying jobs remain in the United States. We are particularly grateful that the discussion draft specifically includes films in the types of "qualified property" eligible for the innovation box deduction. This properly reflects the fact that production of films, like other forms of IP, is highly mobile and susceptible to other developed countries' incentives.

To ensure the purposes of adopting an IP box are fully met with respect to films, we believe that certain modifications should be made that properly account for differences between the development of films and other forms of IP. Most notably, the ratio in the discussion draft is based on incurring R&D expenses, rather than IP production expenditures generally. The production of films, in contrast to most other forms of IP, requires only limited R&D expenses. The numerator and denominator of the nexus ratio should be modified appropriately to reflect all IP development costs (incurred domestically compared to worldwide), not just R&D expenses. Also, the inclusion in the numerator and denominator of costs of an expanded affiliated group will often lead to anomalous results. For example, a corporation with significant business activities unrelated to development of IP, such as cruise ships, will be disadvantaged for no apparent reason relative to competitors without such activities. Conversely, a corporation
that has an affiliate with significant unrelated IP development activities could be advantaged relative to its competitors.

Also, similar to section 199, income derived from film-related copyrights and trademarks should be eligible for the deduction under the discussion draft, because such income is a significant portion of the film’s revenue stream and is essential to the decision whether to produce a film or not.

In addition, on-line viewing is a rapidly evolving portion of the film and television market that should be encouraged. Congress recognized this when it specifically provided that the methods and means of distributing a film should not affect eligibility under section 199. Failure to extend eligibility for innovation box benefits to income derived from digital broadcasts could mean that, as the demand for digital programming grows, the intended tax incentive for domestic film production could shrink substantially over time.

Finally, we believe it is important that the benefits of an innovation box be available to partnerships, as well as corporations. A substantial number of film projects every year are produced through partnerships, co-productions and joint ventures. Film production by partnerships is also susceptible to foreign incentives and the effects of nexus requirements under BEPS. Thus, to counteract those incentives and preserve the U.S. revenue base and jobs, partnerships should also be eligible for innovation box benefits.

An alternative approach to implementing an innovation box in the U.S. would be to adopt an approach similar to the one taken by former Ways and Means Committee Chairman Camp in his tax reform bill (H.R. 1) to address base erosion. By establishing a competitive tax rate on IP income and a balance between the treatment of exported IP and IP owned overseas, the “carrot and stick” approach of H.R. 1 will promote the creation, ownership and commercialization of IP in the United States.

The incentive effect of the “carrot” in H.R. 1 could be enhanced in several sensible ways. For example, the carrot will be heavily dependent on how intangible property development expenses are allocated for purposes of determining foreign intangible income. Specific rules are provided in the regulations under section 861 to allocate and apportion R&D expenses (Treas. Reg. sec. 1.861-17). These rules were adopted in part to encourage domestic research and development. Applying similar allocation and apportionment rules to film industry content and other intangible property for purposes of determining net foreign intangible income would provide similar incentives and help to ensure the carrot properly encourages domestic production of intangible property.

It would also enhance the “carrot” to specify that indirect expenses are not taken into account in computing net foreign intangible income. This would exclude expenses not directly allocable to IP development, including SG&A, stewardship and interest costs.

A similar approach is used in Chairman Camp’s discussion draft to define foreign source taxable income for purposes of the foreign tax credit limitation. This would provide a consistent approach for both purposes.

Finally, similar to the computation of the “stick” (which is done on a CFC-by-CFC basis), net losses from one transaction should not offset net intangible income from other transactions in determining the carrot under the bill.

Conclusion

We are very appreciative of the ongoing work by the Committee and the Subcommittee to improve our tax system in order to promote domestic job growth and enhance the global competitiveness of U.S. businesses.

Our industry is highly sensitive to global competition. Recent technological developments have created an environment where jobs related to the production of underlying works, and the creation and commercialization of valuable intellectual property, are more highly mobile than ever before. Other countries are becoming more aggressive in using lower statutory tax rates, targeted tax incentives, broad innovation box regimes, and other subsidies to attract IP production and ownership overseas. Moreover, the OECD BEPS project has already caused a growing focus on the substance and extent of activities supporting the allocation of profits of a globally integrated enterprise. These actions by the OECD and other highly developed economies are creating a real and immediate threat to U.S. jobs.

We are grateful for your efforts to respond to these challenges so U.S. companies remain highly competitive overseas, and IP development (and the resultant jobs and revenue base) remain at home. We believe that a significant reduction in the U.S. corporate tax rate and adoption of a dividend exemption system with an appropriate innovation box will successfully achieve these goals.

Please contact Patrick Kilcur (202) 378-9175 if you have any questions or need anything else from us. We look forward to working with the Committee members and the staff on these important issues.

Sincerely,

Joanna McIntosh
Executive Vice President, Global Policy and External Affairs

cc:
House Ways and Means Committee Chairman Kevin Brady
Ranking Member Sandy Levin
Members of the Subcommittee on Tax Policy
Statement for the Record

of Dorothy Coleman
Vice President, Tax & Domestic Economic Policy
National Association of Manufacturers

For the Hearing of the House Ways and Means Tax Policy Subcommittee

on "OECD BEPS Project final recommendations and its effect on worldwide American companies"

December 1, 2015
Statement for the Record by
Dorothy Coleman

For the
Hearing of the House Ways and Means Tax Policy Subcommittee

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Chairman Boustany, Ranking Member Neal and members of the subcommittee, thank you for the opportunity to testify today about the Base Erosion and Profit Shifting (BEPS) project spearheaded by the G-20 and the Organisation for Economic Cooperation and Development (OECD). I appreciate the chance to highlight on behalf of the National Association of Manufacturers (NAM) our concerns about some of the recommendations in the BEPS project that would impose substantial and unnecessary compliance costs on companies and, in some cases, force disclosure of sensitive, confidential U.S. taxpayer information. These recommendations would create a new set of challenges for manufacturers and stand to harm our competitiveness in an already difficult global economic environment.

The NAM is the nation’s largest industrial association and voice for more than 12 million women and men who make things in America. Manufacturing in the United States supports more than 17 million jobs, and in 2014, U.S. manufacturing output reached a record of nearly $2.1 trillion. It is the engine that drives the U.S. economy by creating jobs, opportunity and prosperity. The NAM is committed to achieving a policy agenda that helps manufacturers grow and create jobs. Manufacturing has the biggest multiplier effect of any industry and manufacturers in the United States perform more than three-quarters of all private-sector R&D in the nation - driving more innovation than any other sector.

Manufacturers know full well how critically important it is for U.S. companies to be able to invest and compete effectively in the global marketplace. Indeed, 95 percent of the world’s customers are outside the United States. Investment by U.S. global companies has paid off for the U.S. economy: U.S. global companies employ 35.2 million workers and are responsible for 20 percent of total U.S. private industry employment. Moreover, U.S. companies that invest abroad export more, spend more on U.S. research and development performed by U.S. workers and pay their workers more on average than other companies.

Background

In 2012, representatives from the G-20 asked the OECD to develop a comprehensive approach to address aggressive global tax planning that resulted in inappropriate corporate tax avoidance. The OECD released its final recommendations in October 2015 and the recommendations were approved by the G-20 Finance Ministers on October 9, 2015, and by the G-20 Leaders on November 16, 2015.

1 Bureau of Economic Analysis, August 2014.
In July 2013, the OECD released the G20/OECD Base Erosion and Profit Shifting ("BEPS") Action Plan, which provided for 15 actions designed to reach consensus among members for recommended changes in tax policy. The BEPS Action Plan included Action 13, "Re-examine Transfer Pricing Documentation," to develop rules to require multinational companies (MNEs) "to 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."

On October 5, 2015, the OECD released its final report on Action 13 (along with reports on all 15 BEPS Actions). The OECD identified Action 13 as one of the areas where all countries agreed to consistent implementation. The Action 13 report was virtually identical to an earlier draft (released in September 2015) and previously released implementation guidance (released in February and June 2015). Action 13 adopts a three-tiered approach to achieve transfer pricing documentation: a master file containing information to provide a complete picture of the MNE’s global operations, including an organizational chart, consolidated financial statements, and analyses of profit drivers, supply chains, intangibles, and financing; a local file providing more detailed information relating to specific intercompany transactions of the MNE group impacting the specific tax jurisdiction; and a country-by-country report (CbCR) containing aggregated financial and tax data by tax jurisdiction. According to the OECD, the two documents that provide group-wide information – master file and CbCR – are intended to provide governments with information necessary to conduct high-level transfer pricing risk assessment.

The CbCR will only be required of multinational groups with annual consolidated group revenue of at least 750 million Euro in the immediately preceding year. The first CbCRs would be filed for tax years beginning in 2016 with the tax residence country of the parent of the MNE group (e.g., the United States for U.S. MNEs). Other countries could obtain CbCRs through exchange of information processes under bilateral treaties and tax information exchange agreements.

In order to obtain CbCRs, countries must agree to certain conditions related to confidentiality, consistency and appropriate use of the information. In this document, appropriate use is defined as "assessing high level transfer pricing risk" and "other BEPS-related risks." If the tax residence country of the parent company does not collect CbCRs, or has not agreed to provide CbCRs via information exchange, then other countries would be authorized to collect CbCRs directly from subsidiaries in their jurisdictions.

Action 13 includes model legislative language for adopting CbCR requirements and model competent authority agreements for use by governments to implement CbCR exchange. It also provides a detailed framework for confidentiality and data safeguards that need to be in place for countries to receive the CbCR through information exchange.

Under Action 13, the master file and the local file would be collected directly by each local jurisdiction in which the MNE conducts business. Confidentiality, consistency, and appropriate use standards that apply to the CbCR do not explicitly apply to the master file or local file, although participating countries have agreed that the confidentiality and consistent use standards associated with transfer pricing documentation generally "should be taken into account."

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Potential Impact of the CbCR and Master File Requirements

The CbCRs on a company's financial and tax data that companies file with their own country could impose a significant, additional administrative burden on companies. These reports however, would be submitted to foreign countries under bilateral treaties and information exchange agreements and thus have protections to ensure confidentiality, consistency and appropriate use of the information by foreign countries.

Unfortunately, this would not be the case with the master file, which could be required directly by any country where a company does business. The master file asks for extremely sensitive information unrelated to actual taxpayer activities in the country requesting the information. In this way, the master file is similar to the CbCR. However, unlike the CbCR, the master file information does not have the confidentiality protections of the information exchange process and is not subject to any confidentiality, consistency, or appropriate use conditions beyond those that may apply locally.

If a country fails to abide by these conditions with respect to the CbCR, Treasury has stated its intent to suspend CbCR information exchange. To the extent this threat is effective in ensuring that other countries maintain confidentiality of CbCRs of U.S. MNEs, it is irrelevant to the master file, which is arguably more intrusive. With respect to maintaining confidentiality of the master file, U.S. MNEs are at the mercy of foreign governments.

Manufacturers are concerned that the master file requirement would force them to disclose an unprecedented amount of proprietary information about their global operations to foreign governments. The master file would include organizational charts, consolidated financial statements and analyses of profit drivers, supply chains, intangibles, and financing. In short, it would provide a comprehensive plan that includes every aspect of a company's worldwide business.

While a small amount of the required information in the master file may be contained in public filings with the Securities and Exchange Commission (SEC), most of the required information is descriptive in nature and even publicly traded companies will need substantial input from across the business enterprise to recompose the data. Information about global supply chains, for example, can be considered sensitive commercial information that, if disclosed, would be of high value to the MNE's market competitors. For privately held companies, the requirements to include a global organizational chart and consolidated financial statements would constitute an unprecedented level of disclosure to foreign governments. Disclosure, misappropriation, or inappropriate use of this information could be extremely detrimental to the ability of U.S. manufacturers to create value in the United States and global marketplaces.

The fact that taxpayers may have some level of control over what information is included in the master file does little to address confidentiality concerns since it is unclear how much flexibility taxpayers have to exclude sensitive information.

In the Action 13 report, the OECD recommends taxpayers use a "prudent business judgment" standard to determine the "appropriate level of detail" to be included in the master file. Information that is "important," however, cannot be omitted. The OECD considers information to be important "if its omission would affect the reliability of the transfer pricing outcomes."
Manufacturers believe that this standard provides little comfort for taxpayers that want to omit sensitive information and avoid penalties for failing to comply with the filing requirements. There is, at best, a questionable nexus between the master file information and transfer pricing outcomes within a particular country under the arm's length standard, since that is the purpose of the local file. For example, a taxpayer could reasonably take the position that omitting a global organizational chart or consolidated financial statements would not affect the reliability of the transfer pricing outcomes within any particular jurisdiction, yet be concerned that such omissions would constitute non-compliance.

**Addressing Confidentiality Concerns**

Even though the BEPS recommendations were finalized this fall, the NAM strongly believes that taxpayer confidentiality concerns can and should be addressed during the BEPS implementation phase. Specifically, we believe that Treasury should link master file information to its agreements to provide the CbCR to other countries through information exchange. Thus, we urge Congress to ensure that Treasury enters into agreements with foreign countries specifying that:

- Treasury agrees to provide CbCRs for U.S. MNEs only if U.S. MNEs or their subsidiaries are not required to provide master file information to the foreign country;
- The foreign country agrees that it will not collect CbCRs from U.S. MNEs or their subsidiaries; and
- Treasury agrees to provide to the foreign country only the master file information that a U.S. MNE chooses to file with its CbCR in order to provide context for its CbCR data.

**Conclusion**

NAM members recognize the crucial role tax policy plays in the ability of businesses around the world to compete and grow, and we support tax rules that are pro-growth, pro-competitiveness, fair, clear, and predictable. In contrast, the proposed information sharing and disclosure rules included in the BEPS recommendations described above would impose new and unnecessary compliance costs on companies and, in some cases, force disclosure of proprietary business information, creating a new set of challenges for global companies.

In particular, the master file requirement would provide foreign governments with a comprehensive roadmap detailing every aspect of a company's worldwide business. Many manufacturers in the United States with operations overseas would have to comply with this provision, which represents an unacceptable and unprecedented expansion of required proprietary data sharing and a very real competitive threat for some of America's most innovative firms.

Manufacturers are particularly concerned about the lack of safeguards to protect the confidentiality of this very sensitive information in the master file. Unlike the CbCR, the master file is not provided through information exchange and is not subject to any confidentiality, consistency, or appropriate use conditions beyond those that may apply in a local jurisdiction. If a country fails to meet these conditions on CbCRs, Treasury can suspend the information exchange. Unfortunately, this option does not apply to the master file information, which is even more intrusive.
On a positive note, the United States has not announced plans to collect the master file. We urge Treasury officials to go one step further and only provide CbCRs to foreign countries that do not require a master file. At a company’s option, Treasury can provide any master file information the company chooses to provide as context for its CbCR data that is provided through information exchange.

When it comes to tax policy, manufacturers believe a fair and transparent tax climate in the United States—including competitive business tax rates and modern international tax rules—will boost standards of living and economic growth worldwide. At the same time, an appropriate balance needs to be struck between transparency and confidentiality of the proprietary information that enables companies to compete and prosper in a global economy.
The Tax Innovation Equality (TIE) Coalition is comprised of leading American companies and trade associations that drive economic growth here at home and globally through innovative technology and biopharmaceutical products. For more information, please visit http://www.tiecoalition.com.
that proposal, Chairman Camp chose to use what is now widely known as “Option C.”2 The problem with “Option C,” is if it became the law of the land, its adverse tax treatment of IP income would significantly hinder U.S. companies who compete globally, and it would result in more inversions of U.S companies. The TIE Coalition is opposed to “Option C” because it would have a devastating impact on both innovative technology and biopharmaceutical companies.

In an effort to really understand the full scope of “Option C,” the TIE Coalition earlier this year commissioned a study by Matthew Slaughter, the Dean of the Tuck School of Business at Dartmouth University. The January 2015 study, entitled “Why Tax Reform Should Support Intangible Property in the U.S. Economy” can be found at http://www.tiecoalition.com/why-tax-reform-should-support-intangible-property-in-the-u-s-economy and we urge the Ways and Means Committee to consider its findings when examining options for international tax reform.

As Dean Slaughter emphasizes, “Policymakers should understand the long-standing and increasingly important contributions that IP makes to American jobs and American standards of living—and should understand the value of a tax system that encourages the development of IP by American companies.” The study finds that “Option C” in the Camp legislation would fundamentally change the measurement and tax treatment of IP income earned by American companies abroad. The study finds that “Option C” of the proposal would disadvantage IP income earned abroad by U.S. companies in three ways. First, it would tax IP income at a higher rate than under current law. Second, it would tax IP income more than other types of business income. Third, it would impose a higher tax burden on the IP income of U.S. companies compared to their foreign competitors. The likely outcome of using “Option C” as proposed in the Camp legislation would be to increase corporate inversions and incentives for foreign acquisitions of U.S.-based IP-intensive companies.

The Slaughter study finds that the “United States, not abroad, is where U.S. multinationals perform the large majority of their operations. Indeed, this U.S. concentration is especially pronounced for R&D, which reflects America’s underlying strengths of skilled workers and legal protections such as IP rights that together are the foundation of America’s IP strengths, as discussed earlier.” The Slaughter study concludes that the overseas operations of these companies complement their U.S. activities and support, not reduce, the inventive efforts and related jobs of their U.S. parents. So it is increasingly important to America’s IP success that these companies continue to operate profitably overseas and any tax reform proposals do not impose discriminatory taxes on income from intangible assets located there.

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2 Please note that the TIE Coalition is opposed to both versions of “Option C” (version one of “Option C” in the Camp Draft and version two of “Option C” in H.R. 1 as introduced).
IP jobs are very important to the U.S. economy and make up a large portion of the workforce. That is why it is important to have a tax code that supports the IP economy here in the U.S. To that point, the U.S. Chamber’s Global Intellectual Property Center commissioned a study on the benefits of IP jobs to economic growth in the U.S. The study found that in 2008-09 that there were 16% or 19.1 million direct IP jobs and 30% or 36.6 million indirect IP jobs in the U.S. IP or IP related jobs account for 46% of the U.S. economy or 55.7 million jobs. With our modernizing economy it is likely that this number has grown.

To be constructive and help the Subcommittee find solutions that will allow American companies to succeed in a very competitive global market, the TIE Coalition has developed anti-base erosion solutions that do not target IP income. We would like to work with the Subcommittee to develop alternative options that would apply to situations in which companies are simply trying to shift income to low tax jurisdictions with no substance or real business presence, but would not discriminate against income from intangible assets. Such options would apply to income from all goods and services, not just income from intangible assets.

In conclusion, the TIE Coalition supports tax reform that modernizes the U.S. tax system, allowing American businesses to compete in global markets in a manner that does not discriminate against any particular industry or type of income, including income from intangible property. As the witnesses at this hearing indicated, many other countries are lowering their corporate tax rates and adopting tax rules to attract IP companies to their shores. So, it would be especially harmful to the U.S. economy to adopt a tax policy that will hurt, not help, American companies who compete globally. Now is not the time to drive high paying American jobs overseas.

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4 The U.S. Chamber study found that “IP-intensive companies added more than $2.8 trillion direct output, accounting for more than 23% of total output in the private sector in 2008-09” and that “Output per worker in IP-intensive companies averages $136,556 per worker, nearly 72.5% higher than the $79,163 national average.”