ANNEXURE 9

DAVIS TAX COMMITTEE: SECOND INTERIM REPORT ON BASE EROSION AND PROFIT SHIFTING (BEPS) IN SOUTH AFRICA*

SUMMARY OF DTC REPORT ON ACTION 11: MEASURING AND MONITORING BEPS

It is commonly accepted that multinationals engage in activities that are intended to shift profits from jurisdictions where they do business to low tax jurisdictions and thereby erode tax bases of their residence or source countries. So far, not much attention has been paid to measuring the scale and impact of tax avoidance resulting in base erosion and profit shifting ("BEPS"). The OECD concedes that although measuring the scale of BEPS proves challenging because the complexity of BEPS and the serious limitations of data, it is now known that the fiscal effects of BEPS are significant.[1]

In light of this the OECD Report adopts six indicators referred to as a "dashboard of indicators" that are used to measure and effectively confirm the existence of BEPS. The limitation of currently available data remains a serious constraint in the effectiveness of the proposed indicators. Additionally, in the general examination of profit shifting, the said indicators being no exception, it has been found to be difficult to separate the effects of BEPS from real economic factors and the effects of deliberate tax policy choices.[2]

Action 11 acknowledges the existence of other empirical studies that cement their position on that occurrence of BEPS through transfer pricing, strategic location of intangibles and debt and treaty abuse. Unfortunately, the said studies are also impacted by the serious data limitation and, consequently, the same inability to separate the effects of BEPS from real economic factors and effects of deliberate tax policy choices.

As a result, the OECD Action 11 Report emphasises the notion that improving tools and data available to measure BEPS will be critical for measuring and monitoring BEPS in the future, as well as evaluating the impact of countermeasures developed in the OECD Action Plans. These sentiments are seen and reiterated throughout the entire text of the Report and reflected in the six proposed recommendations for improving BEPS data

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1 OECD/G20 2015 Final Report on Action 11 at 15.

2 OECD/G20 2015 Final Report on Action 11 at 16.

collection and analysis. While the need to improve the economic and fiscal analysis of BEPS requires greater access to this data, the Report suggests that any recommendations around the availability of data in the future must take into account the need to protect the confidentiality of taxpayer information and minimise the administrative burden for governments and taxpayers.[3]

The structure of the Report is as follows: Chapter 1 of the Report examines existing data sources relevant for BEPS analysis and concedes that the existing insufficiency can be addressed by improved tools and data sources. The gist of Chapter 1 eventually culminates *mutatis mutandis* into recommendations 1, 4 and 5 to the Report. Chapter 2 on the other hand looks specifically at indicators of base erosion and profit shifting, the deficit of which ultimately metamorphoses into recommendation 3 to the Report. In tune with the golden thread, the report states that the endeavour to develop more refined indicators can only be materialised once data sources are improved.[4] Chapter 3 looks towards measuring the scale and economic impact of BEPS and countermeasures and the result is reflected in recommendation 2 with certain relevant aspects emanating in recommendations 4 and 5.[5]

In line with the OECD recommendations, this report recommends the following for South Africa, that:

1. South Africa works with the OECD to publish a new Corporate Tax Statistics publication, which would compile a range of data and statistical analyses relevant to the economic analysis of BEPS;
2. South Africa works with the OECD to produce periodic reports on estimated revenue impacts of proposed and enacted BEPS countermeasures;
3. The South African government improves the public reporting of Business Tax Statistics particularly for MNEs;
4. South Africa continues to make improvements in non-tax data relevant to BEPS; and
5. South Africa considers current best practices and explores new approaches to collaborating on BEPS research with academics and other researchers.

[3] OECD/G20 2015 Final Report on Action 11 at 250.
[4] OECD/G20 2015 Final Report on Action 11 at 42.
[5] See para 3 below.

DTC REPORT ON ACTION ON ACTION 11: MEASURING AND MONITORING BEPS

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1 INTRODUCTION

Much is talked about base erosion and profit shifting (BEPS), and all the activities and practices that multinationals undertake in order to achieve BEPS. The need to combat such activities is evidenced by efforts that countries make developing tax provisions, and improving certain existing tax provisions, in order to combat tax avoidance resulting in BEPS. Such efforts are now being further supported by the enormous work that the OECD has undertaken in developing the BEPS Action Plan.

Not much attention has, however, so far been paid on measuring the scale and impact of tax avoidance resulting in BEPS. The amount of effort and resources that countries place on measures to combat BEPS should be relative to the impact that BEPS has on tax revenues. Without a proper indication of such impact, the effort and resources could be disproportionate (either on the upside or the downside) to the effort and resources applied.

Along with most other jurisdictions, South Africa has not developed a measuring and monitoring system to determine the economic impact of tax avoidance and BEPS. As such the scale of the economic impact of BEPS in South Africa is unknown. Focus has been placed on closing tax loopholes and curbing tax avoidance using instruments such as reportable arrangements and general and specific anti-avoidance measures. The South African Revenue Authority's Tax Avoidance and Reportable Arrangements division employs huge resources in monitoring tax avoidance schemes and behaviour. However, no resources are placed on specifically monitoring and measuring the impact of such tax avoidance and BEPS.

It is against this background that Action 11 of the OECD is important for South Africa.

2 THE OECD 2015 FINAL REPORT ON ACTION 11: MEASURING AND MONITORING BEPS

2.1 BACKGROUND

According to the OECD, an analysis of financial accounts from a cross-country database estimates the global corporate income tax revenue losses as a result of BEPS to be in the range of 4% to 10% of corporate income tax revenues, i.e. USD 100 to 240 billion annually[1] at 2014 levels. The studies estimating the fiscal effects on developing

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countries, as a percentage of their GDP, find that these effects are higher than in developed countries, given the greater reliance on CIT revenues and often weaker tax enforcement capabilities of developing countries, but in some cases these studies also include revenue lost from non-BEPS behaviours.[2] The Report considers that BEPS countermeasures would increase taxes paid by multinational enterprises (MNEs) engaging in BEPS, but other businesses and households will benefit from lower taxes or increased public infrastructure or increased government services, and indirectly through a more level playing field.

The Report on Action 11 acknowledges that the fiscal effects of BEPS are thus significant, although there is only anecdotal evidence that shows that tax planning activities of some MNEs take advantage of the mismatches and gaps in the international tax rules, separating taxable profits from the underlying value-creating activity. The OECD, 2013 BEPS Report recognised that the scale of the negative global impacts on economic activity and government revenues have been uncertain.[3]

Given developing countries' greater reliance on corporate income tax revenues, estimates of the impact on developing countries, as a percentage of GDP, are higher than for developed countries. As indicated above, in addition to significant tax revenue losses, BEPS is said to cause other adverse economic effects, including tilting the playing field in favour of tax-aggressive MNEs, exacerbating the corporate debt bias, misdirecting foreign direct investment, and reducing the financing of needed public infrastructure. Six indicators of BEPS activity highlight BEPS behaviours using different sources of data, employing different metrics, and examining different BEPS channels.[4] When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

Existing empirical studies and new empirical analysis of the fiscal and economic effects of BEPS find the existence of profit shifting through transfer mispricing, strategic location of intangibles and debt, as well as treaty abuse.[5] In addition these studies and analyses and BEPS indicators confirm that profit shifting is occurring, is significant in scale and is likely to be increasing, and that it also creates adverse economic distortions. The Report states that "empirical analysis indicates that BEPS adversely affects competition between businesses, levels and location of debt, the location of

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1 OECD/G20 2015 Final Report on Action 11 at 15.

2 OECD/G20 2015 Final Report on Action 11 at 80.

3 See 2013 OECD/G20 BEPS report on action 11 at 58-60.

4 *Ibid.*

5 OECD/G20 2015 Final Report on Action 11 at 16.

intangible investments, and causes fiscal spillovers between countries and wasteful and inefficient expenditure of resources on tax engineering."[6]

The Report states that it is critical that the tools and data available to measure and monitor BEPS should be improved, as well as evaluating the impact of the countermeasures developed under the BEPS Action Plan. The Report also makes a number of recommendations that will improve the analysis of available data. The Report acknowledges that some of the information needed to improve the measurement and monitoring of BEPS is already collected by tax administrations, but not analysed or made available for analysis. The focus of the Report's recommendations in this area is on improved access to, and enhanced analysis of, existing data, and new data proposed to be collected under Actions 5, 13 and, where implemented, Action 12 of the BEPS project.[7]

The report recommends that the OECD work with governments to report and analyse more corporate tax statistics and to present them in an internationally consistent way. These improvements in the availability of data will ensure that governments and researchers will, in the future, be better able to measure and monitor BEPS and the actions taken to address BEPS.[8]

2.2 ASSESMENT OF EXISTING DATA SOURCES RELEVANT FOR BEPS ANALYSIS

The Report acknowledges that having a thorough understanding of the available data would provide a solid base for working towards 'best practices' in future data collection to 'fill the gaps' and strive for more comprehensive data and comparability across countries. This should be done with full recognition of the trade-offs between the objectives of improved tax policy analysis, and the need to minimize administrative costs for tax administrations and businesses.[9]

One of the key challenges with currently available data sources is that it is difficult for researchers to disentangle real economic effects from the effects of BEPS-related behaviours. Accordingly the Report assesses a range of existing data sources with specific reference to the availability and usefulness of existing data for the purposes of developing indicators, and undertaking an economic analysis, of the scale and impact of BEPS and BEPS countermeasures.

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6 OECD/G20 2015 Final Report on Action 11 at 16.
7 *Ibid.*
8 *Ibid.*
9 OECD/G20 2015 Final Report on Action 11 at 18.

2.3 POTENTIAL CRITERIA FOR EVALUATING AVAILABLE DATA FOR BEPS RESEARCH

In evaluating available data, the Report recommends that the following set of criteria could be considered:

Coverage/Representativeness – BEPS is a global issue and significant profit shifting may occur through "small" entities with large profits but with little economic activity. Determining the coverage and representativeness of the underlying data is critical to assessing the results of any analysis. Most databases are limited to individual countries or a region, and there is no truly comprehensive global database of MNE activity.[10]

Usefulness for separating real economic effects from tax effects – Separating BEPS-related activity from real economic activity is important, but must be estimated. National Accounts and macroeconomic statistics, such as foreign direct investment data, combine both real and BEPS related activity. Firm-level data provides researchers with more information to attempt to more accurately separate BEPS-related activities from a firm's real economic activities.[11]

Ability to focus on specific BEPS activity – BEPS is driven by practices that artificially segregate taxable income from the real economic activities that generate it. A MNE's financial profile can be very different between financial and tax accounts. Differences in financial and taxable income can be large, and the country of taxation can differ from the firm's country of incorporation. In some cases, specific tax information may be available for a limited number of MNEs from specific parliamentary enquiries.[12]

Level of detail – As BEPS behaviours involve cross-border transactions, typically between related parties, information on related and unrelated party transactions should be used when available. Affiliate-level information should supplement worldwide consolidated group information when available. Different types of foreign direct investment data should be used when available.[13]

Timeliness – Access to timely information enables policymakers to monitor and evaluate the changes in the BEPS environment and the effects of legislation. If the time lag is too long, empirical analysis may be more of an historical assessment, rather than an analysis of recent developments.[14]

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10 OECD/G20 2015 Final Report on Action 11 at 19.
11 OECD/G20 2015 Final Report on Action 11 at 19.
12 OECD/G20 2015 Final Report on Action 11 at 19-22.
13 OECD/G20 2015 Final Report on Action 11 at19-22.
14 OECD/G20 2015 Final Report on Action 11 at 19-23.

Access to the information – MNE tax reports are available to tax administrators, However, BEPS behaviour cannot be necessarily identified as specific entries on tax returns or financial accounts. Therefore an analysis of the data is required to separate BEPS behaviours from real economic activity. To that end, policymakers need economic analyses of BEPS and BEPS countermeasures, rather than just compilations of descriptive statistics. The extent to which access to data is provided to statisticians and economists within government, and potentially outside of government, with strict confidentiality rules, represents an important policy issue.[15]

There are other data issues to be dealt with by analysts before conclusions can be reached on BEPS e.g. balance sheets typically reflect only purchased, and not developed intangibles; intangibles include not only intellectual property but also trade names and brands; accounting tax rates (headline or effective) which are not always reflective of BEPS or non-BEPS related activities; data collected through sampling raises questions as to weighting; data collection may only reflect historical positions and may also be impacted by economic conditions. [16]

Currently available data sources for BEPS analysis includes: (i) national accounts, (ii) balance of payments (BOP); (iii) foreign direct investment (FDI) statistics; (iv) aggregate data on bilateral trade by product; (v) corporate income tax revenue, and tax return and tax audit information; (vi) customs data; (vii) company financial information from public and proprietary databases and government databases; (viii) tax audit information; and (ix) detailed specific company tax information.[17]

Analysis of BEPS requires identifying where MNE behaviours or arrangements "achieve no or low taxation by shifting profits away from jurisdictions where the activities creating those profits take place. No or low taxation is not *per se* a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it."[18] This description of BEPS is important in assessing the currently available data.

This initial analysis requires the following:[19]

- Firm-level data for the best analysis of BEPS;
- More complete information about global MNE activity to analyse BEPS;
- Additional analysis of tax return information; and

15 OECD/G20 2015 Final Report on Action 11 at 19 and 23.
16 OECD/G20 2015 Final Report on Action 11 at 23.
17 OECD/G20 2015 Final Report on Action 11 at 24-26.
18 OECD/G20 2015 Final Report on Action 11 at 26.
19 OECD/G20 2015 Final Report on Action 11 at 26-32.

- Making the most of available information and identifying gaps.

Some current best practices in using available data for BEPS analysis are the following:[20]

Germany – The Deutsche Bundesbank houses the Micro database on Direct Investment, which is a full census of foreign firms' affiliates in Germany. It covers directly and indirectly foreign affiliates of German firms above a certain size and ownership thresholds. It contains balance sheet data at firm level (including at affiliates and parent company levels), ownership variables, information on liabilities of shareholders, shares in the assets and liability positions of non-residents. The information is kept confidential but made available, under strict conditions, for research purposes.

Sweden – Government analysts in Sweden have access to detailed, anonymised taxpayer information from filed tax returns, including balance sheets and information on domestic employees, employee compensation and the value of tangible and intangible assets. It distinguishes between MNEs and purely domestic Firms. However, the data lacks detailed income information on foreign subsidiaries. The OECD Report notes that this type of practice could be replicated in other countries.

Latin America – Some tax authorities, such as in Argentina, request companies to present special forms with information relating to transactions with related parties as well as with entities located in non-cooperative jurisdictions, and non-related parties. The information covers trade in goods and specifies prices, volumes and trading partners. Some countries share such data with international organizations, upon request, which suggests that comparable data for developing countries may be possible.

United States – The United States Bureau of Economic Analysis (BEA) surveys both United States headquartered firms (and their affiliates abroad) and subsidiaries in the United States of foreign headquartered firms. Firms are obliged to participate in surveys, the aggregated data outcomes of which are available publicly and micro data can be accessed by non-governmental researchers under strict confidentiality rules.
The US Internal Revenue Service also collects data regarding CFC's of US parents and vice versa. Such information is tabulated and made available for certain government analysts and approved non-government researchers.

[20] OECD/G20 2015 Final Report on Action 11 at 33.

In 2011, the OECD Expert Group for International Collaboration on Microdata Access was formed to examine the challenges for cross-border collaboration with micro data. The resulting 2014 report 21 notes: "*The challenge in the 21st Century is to change practices in access to micro data so that the access services can cross borders and support trans-national analysis and policy making. This is necessary to reflect the increasingly international (global) reach and impact of comparative analysis and shared policy making*."[21] Highlighting the importance of comparability and working towards homogeneity in data collection across countries, the Expert Group report recommends smarter deployment of what already exists in most OECD countries.[22]

The Report concludes that existing databases used for economic analysis of BEPS should be checked to see if identified cases of BEPS are included in the data. However, it further concludes that its assessment of the currently available data for economic analysis of BEPS and potential countermeasures identified significant data limitations, data issues, and in some cases data gaps in the various data sources currently available for analysing BEPS and BEPS countermeasures.[23]

2.4 INDICATORS OF BEPS

OECD Action 11 states that the first step in developing useful indicators is defining the concept:
"BEPS relates to arrangements that achieve low or no taxation by shifting profits away from the jurisdictions where the activities creating those profits take place or by exploiting gaps in the interaction of domestic tax rules where corporate income is not taxed at all. No or low taxation is not *per se* a cause of BEPS, but becomes so when it is associated with practices that artificially segregate taxable income from the generate it."[24]

OECD Action 11 Report then outlines dictionary definitions of an indicator to include;[25]

- An index that provides an indication, especially of trends;
- A meter or gauge measuring and recording variation;
- A device to attract attention, such as a warning light;
- An instrument that displays certain operating conditions such as temperature; and
- A pointer on a dial showing pressure or speed.

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21 OECD/G20 2015 Final Report on Action 11 at 34.
22 OECD/G20 2015 Final Report on Action 11 at 35.
23 OECD/G20 2015 Final Report on Action 11 at 35.
24 OECD/G20 2015 Final Report on Action 11 at 42.
25 OECD/G20 2015 Final Report on Action 11 at 42.

The idea of BEPS indicators is closely woven into Action 11's golden thread and immediately highlights that as with any gauge," the degree of precision depends on the available information and the accuracy of the measurement tools."[26] Simply, the better the tools and information available, the more precise and accurate the indicator becomes. The Action 11 Report further notes that one of the main deficiencies with the current data analysis is that" 'at this stage BEPS indicators can only provide some general insights into the scale and economic impact of BEPS, but will necessarily lack the precision that may become possible if more comprehensive and improved data sources where to be used in the future"[27]

The OECD Report further concedes that no single indicator can be used to provide a complete picture of the scale and economic impact of BEPS and as such the concept followed in developing the BEPS indicators has been to create a "dashboard of indicators" that provide an indication of the scale of BEPS and help policymakers monitor changes in the scale of BEPS overtime. In light of this and given the currently available data, multiple indicators help identify trends regarding the scale of BEPS and changes in BEPS and specific BEPS behaviours.

As a further acknowledgement of the need for more thorough and targeted data, current BEPS indicators, developed from currently available data, give a view of how such indicators could be enhanced if more comprehensive data was to become available in the future.[28] To cement this proposition the Report outlines three scenarios i.e. the current state, future state and ideal state, the substance of which is to demonstrate the benefit that more comprehensive tools and data will have on the indicators. In the "future state" for example, the emergence of new data sources will make the indicators more insightful and enable them to give a deeper economic analysis whereas in the "ideal state" the indicators would have more accurate and direct in estimates of BEPS and effectiveness of BEPS countermeasures.

One of the biggest challenges underpinning the production and refinement of analytical tools and BEPS indicators (couched in the Report as a "significant caution") is that BEPS activity is amalgamated into and effectively taints available measures of real economic activity such as corporate income tax bases, financial accounting statements, and even national aggregate measures of economic activity in the corporate sector. In light of this and the existing limitations in the current data, the indicators are designed to be illustrative rather than definitive.

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26 *Ibid*

27 *Ibid.*

28 OECD/G20 2015 Final Report on Action 11 at 43.

Despite these shortcomings, the Report presents six indicators and a further two potential indicators to assist with the measurement and monitoring of BEPS. These indicators are intended to be viewed like a meter or a gauge, capable of measuring trends and variations over time and acting as "warning lights" that might point to the existence of BEPS. No single indicator is capable of providing the complete picture, but by presenting a "dashboard" of BEPS indicators this report provides new insights regarding the presence and scale of BEPS.[29]

The following five categories of indicators containing six indicators of BEPS, have been identified in the report:

1. Disconnect between financial and real economic activities (Indicator 1): concentration of high levels of foreign direct investment relative to GDP). This indicator is based on foreign direct investment (FDI) relative to GDP and shows that both the net and gross FDI stocks relative to GDP of a group of countries with high-ratios (above 50% for net and above 200% for gross) have continued to grow in recent years, when compared with the average of all other countries. The net FDI to GDP ratio of those countries increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.

   The information for this indicator was sourced from the OECD Foreign Direct Investment Statistics providing data on inward and outward FDI stock to and from OECD countries for the 214 countries identified in the OECD database. According to the Report the indicator showed a concentration of FDI in a select group of countries that is disproportionate to the real economic activity (as measured by GDP) in the said countries. It is worthy to note that FDI includes real investment and purely financial transactions (such as mergers and acquisitions) and cannot distinguish between BEPS and other transactions. Action 11 concludes that a high indicator may flag potential BEPS.[30]

2. Profit rate differentials within top global MNEs.[31] (Indicators 2 and 3:
   a. differential profit rates compared to effective tax rates; and
   b. differential profit rates between low-tax locations and worldwide MNE operations);

   This dual pronged indicator shows that lower effective tax rates (ETRs) are correlated with higher profit rates amongst affiliates. It shows that 45% of the income of the largest global MNEs was reported by affiliates with below-average ETRs and above average profit rates. These affiliates represented only 33% of

[29] OECD/G20 2015 Final Report on Action 11 at 46.
[30] OECD/G20 2015 Final Report on Action 11 at 49-51.
[31] OECD/G20 2015 Final Report on Action 11 at 52-56.

total affiliates in the MNE. The value of the indicator increased 32% between 2007 and 2011.

The use of ratios of profits to measure economic activity recognises that BEPS is characterised by disconnecting where the profit is reported and where the economic activity generating the profit is. Indicators herein use a relative measure. The indicator on differential profit rates compared to effective tax rates focuses on the percentage of the total reported income being earned by those lower tax, higher profit affiliates. Indicator 2's findings state that in 2011 lower-tax, higher-profit affiliates accounted for 45% of the total income reported by affiliates in the sample.

The indicator on differential profit rates between low-tax locations and worldwide MNE operations compares the profit rate (i.e. profit/assets) of top global MNE affiliates in low-tax rate jurisdictions with the MNE worldwide profit rate. Findings under this indicator state that in 2011 profit rates of affiliates in lower-tax countries of 171 of the largest MNEs were on average almost twice as high as their worldwide MNE group profit rates (i.e. ratio of 2:0).

3. MNE vs. "comparable" non-MNE effective tax rate differentials[32] (Indicator 4): effective tax rates of large MNE affiliates relative to non-MNE entities with similar characteristics). This indicator shows that lower ETRs are correlated with higher profit rates amongst affiliates. It shows that reported profit rates of MNE affiliates in lower-tax countries were, on average, almost twice as high as their group's worldwide profit rate.

   This indicator compares the ETR of large MNE affiliates with non-MNE entities with similar characteristics in the same country. It measures the extent to which large MNE's have lower ETRs than comparable non-MNE (domestic) entities. Indicator 4 finds that on average, a large MNE affiliate ETR over domestic firms with similar characteristics fluctuating around the level of -3 percentage points with fluctuations not being significant from a statistical point of view.

4. Profit shifting through intangibles[33] (Indicator 5: concentration of high levels of royalty receipts relative to research and development spending). This indicator shows that royalties received relative to R&D expenditures in a group of countries with ratios above 50% are six times higher than for the average of all other countries, up from three times higher in 2009. Based on macro level data

[32] OECD/G20 2015 Final Report on Action 11 at 56-57.
[33] OECD/G20 2015 Final Report on Action 11 at 60-62.

this indicator provides for an indirect measure of BEPS related to intangible property i.e. it being based on macro-level data on royalty payments. The rationale is that transferring intellectual property from a higher tax country where R&D takes place to a lower tax country is one channel facilitating BEPS. The indicator used Balance of Payments and R&D expenditure from the World Bank, World Development Indicators. The findings from the 59 countries in 2011 are evidence of four countries having a ratio of over 50%. It should, however, be noted that the indicator evidences the existence of BEPS but does not measure the scale of BEPS; and

5. Profit shifting through interest[34] (Indicator 6: interest expense to income ratios of MNE affiliates with above average statutory tax rates (STR)). This indicator shows the concentration of high interest-to-income ratios in higher statutory tax rate countries. It shows that the largest global MNEs' affiliates with high interest-to-EBITDA ratios, located in high-tax countries have an interest-to-EBITDA ratio almost three times higher than their groups' worldwide unrelated-party interest-to-EBITDA ratio.

   Based on MNE and firm level financial information from ORBIS database, this indicator measures excess interest-to-income ratio reported by MNE affiliates with relatively high income-to-interest ratios located in countries with STR's above the weighted average. This was done by dividing the affiliates into four quadrants, based on their interest-to-income ratios and their statutory tax rates. The results show the above average interest-to-income ratio by MNE affiliates with relatively high interest-to-income ratios located in high tax countries. Before interest, depreciation and amortisation expenses, interest accounted for 29% of their pre-tax income. This exceeded the average ratio (10%) by 19%.

Two additional indicators are also described that could, in the future, be calculated when new data becomes available:

6. A comparison of profit rates and ETRs for MNE domestic (headquarter); and ~~(B)~~ foreign operations. This indicator compares the profit rate differential between the MNE's domestic operations in the jurisdiction of its headquarters and the MNE's foreign operations to the MNE's differential between domestic and foreign operations. These differentials are then measured as the difference between the domestic and foreign values. Both differentials can be positive or negative.

[34] OECD/G20 2015 Final Report on Action 11 at 63-65.

7. Differential rates of return on FDI investment from special purpose entities. This macro-economic indicator could measure the extent to which FDI inward positions are coming from countries with significant outbound FDI through SPEs, serving as investment conduits. These are countries with relatively large shares of FDI outward investment stocks accounted for by SPEs.

The Report also provides formulas for calculating indicators.[35]

The Report advocates the use of these indicators because they can be calculated historically, on an annual basis, to track direct changes in BEPS over time, as well as to make future calculations once more accurate and comprehensive data is made available. Further, it is provided that the said indicators can be updated relatively quickly from data that is available on a timely basis. Action 11 further highlights that the nature of the current indicators permits them to be refined and extended by academics and other researchers to improve their ability to transparently measure BEPS. This ties well with Recommendation 6 which calls upon governments to encourage academics, researchers and scholars to undertake studies to improve the understanding of BEPS.[36] On the other hand the Report discloses that all indicators should be interpreted taking into account their inherent limitations. With the notion of multiple indicators or a "dashboard of indicators" Action 11 Report concedes that no single indicator can be used to effectively measure the scale of BEPS and changes in BEPS over time. Further, indicators should acknowledge the existence of genuine economic activity unrelated to BEPS in the data they interpret. An example is given with specific reference to Indicator 1 on FDI data in Category A because attracting high levels of real FDI may come as a result of an attractive investment climate divorced from any BEPS activity. This limitation extends from the realisation that currently available data is unable to draw a clear distinction between BEPS related activity and genuine economic activity.[37]

2.5 MEASURING THE SCALE AND ECONOMIC IMPACT OF BEPS AND COUNTERMEASURES

The Report summarises the available empirical analyses of profit shifting and the effects of previously implemented anti-avoidance countermeasures. The Report finds that recent research has focused on specific types of BEPS behaviours, mostly on transfer mispricing and debt shifting, but also on treaty abuse, controlled foreign corporation rules, hybrid mismatch arrangements, and disclosure rules, but more empirical analysis is needed in all of these areas. No empirical studies comprehensively cover global MNE

[35] OECD/G20 2015 Final Report on Action 11 in Annex2.A1.
[36] OECD/G20 2015 Final Report on Action 11 at 47.
[37] OECD/G20 2015 Final Report on Action 11 at 41.

activity as most studies are constrained by a lack of data relating to MNE entities in many countries, and where information regarding MNE entities is available it is often incomplete.[38]

Statistical analyses based upon data collected under the Action 13 Country-by- Country Reports have the potential to significantly enhance the economic analysis of BEPS. However, even with additional data and sophisticated estimation methodologies, researchers of the scale, prevalence and intensity of BEPS will still have difficulty in fully separating BEPS from real economic activity and from non- BEPS tax preferences.[39]

The Report points to recent studies that have presented estimates of the scale of BEPS globally or for individual countries which show significant fiscal effects using different types of data and different estimation methodologies.[40] As stated earlier an OECD analysis of financial accounts from a cross-country database estimates the global corporate income tax revenue losses to be in the range of 4% to 10% of corporate income tax revenues, i.e. USD 100 to 240 billion annually at 2014 levels. The studies estimating the fiscal effects on developing countries, as a percentage of their GDP, find that these effects are higher than in developed countries, given the greater reliance on corporate income tax revenues and often weaker tax enforcement capabilities of developing countries, but in some cases these studies also include revenue lost from non-BEPS behaviours.

The Report finds that BEPS involves MNEs manipulating the location of external and internal debt; reduces the effective tax rate on intangible investments, thereby distorting the types of investments made; affects the location of patent registrations, and to a lesser extent actual R&D activity; affects the location of different types and forms of foreign direct investment; and creates tax base and policy spillovers between countries.

OECD research finds that BEPS reduces the effective tax rate of large MNE entities by 4 to 8½ percentage points on average compared to similarly-situated domestic-only affiliates, providing a competitive advantage in product and capital markets.[41] The reduction in effective tax rates is larger for very large firms and firms with patents. Analyses of BEPS make comparisons of current business activity with some alternative or “counterfactual.” The counterfactual could be a hypothetical “world without BEPS” or a hypothetical “world without co-ordinated multilateral action.” When evaluating BEPS

38 OECD/G20 2015 Final Report on Action 11 at 79.
39 *Ibid.*
40 OECD/G20 2015 Final Report on Action 11 at 88-90.
41 OECD/G20 2015 Final Report on Action 11 at 80.

countermeasures, the estimated counterfactual of the effects of implementing countermeasures can be compared with current law rules and revenues.[42]

BEPS anti-avoidance measures previously implemented by countries have been found to be effective, in countries' fiscal estimates, in academic studies, and in OECD research, to reduce tax planning. Thus, countries with higher statutory corporate tax rates do not necessarily have higher fiscal losses from BEPS if they have strict anti-avoidance rules. International co-ordination of those rules will increase the effectiveness of BEPS countermeasures while reducing the cost of compliance for businesses.[43]

The Report states that the extent of BEPS-induced distortions depends on two factors, namely

- who currently benefits from BEPS: and
- whether the tax savings from BEPS are passed along in lower consumer prices, higher wages to workers, or to higher returns to capital owners.[44]

As earlier stated BEPS countermeasures will increase taxes paid by MNEs engaging in BEPS, but other businesses and households will benefit from lower taxes or increased public infrastructure or increased government services, and indirectly through a more level playing field. The report suggests that the effects on all businesses and households need to be included in analyses of countermeasures. The analysis needs to consider who benefits from BEPS, since if BEPS increases the after-tax economic rents of MNEs engaging in BEPS, countermeasures may not affect some of their investment decisions. Additional research is required on MNEs' investment decisions, determinants of profitability, business tax preferences, and total business taxes to enhance the economic analysis of BEPS and BEPS countermeasures.[45]

The key issues in measuring and analyzing BEPS are:[46]

- Defining BEPS;
- The counter-factual for BEPS analysis, i.e. using the hypothetical world without BEPS;
- Separating BEPS from real economic activity;
- Determining what profits are generated;
- Separating BEPS from non-BEPS tax preferences; and
- Measuring the appropriate tax rate for BEPS analysis.

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42 *Ibid.*
43 *Ibid.*
44 *Ibid.*
45 OECD/G20 2015 Final Report on Action 11 at 80.
46 OECD/G20 2015 Final Report on Action 11 at 82-88.

2.6 DIFFERENT APPROACHES USED TO ESTIMATE PROFIT SHIFTING

Different approaches are used to estimate profit shifting such as:

- coverage by country;
- coverage by MNE relationships;
- tax rate variables;
- tax rate differential variables;
- explanatory economic variables;
- fixed effects variables;
- semi-elasticity v elasticity measures;
- cost of tax planning or linear vs non-linear tax effects; and
- time period and different methodologies.[47]

The Report describes the empirical analyses of overall profit shifting, estimates of the fiscal effects of BEPS, the empirical analyses of the effects of BEPS countermeasures and particular channels of BEPS, and the economic impacts of BEPS and countermeasures.

2.7 BEPS AND DEVELOPING COUNTRIES

As South Africa is a developing country, an analysis of the impact of BEPS in developing countries is important as is determined in the Report. According to the Report, due to limitations of the available data, both in terms of quality and quantity, empirical research of profit shifting in developing countries is quite limited. Attempting to fill the gap on developing country studies of BEPS, Fuest, Hebous and Riedel[48] empirically examine income shifting from developing countries by focusing on related party loans. Their results show that related party debt in developing countries is significantly more sensitive to changes in corporate tax rates than in developed countries. The study concludes that profit shifting, measured relative to current CIT collections, is about twice as large in developing countries as in developed economies. The IMF[49] suggests that revenue losses as a percent of corporate income tax revenues in developing countries could be several multiples of those in developed countries, due to weaker enforcement resources.[50]

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47 OECD/G20 2015 Final Report on Action 11 at 91.

48 Fuest C, Hebous S and Reidel N (2011) "International debt shifting and multinational firms in developing economies" *Economics Letters* page 135 – 138.

49 IMF (2014) "Spillovers in International Corporate Taxation" *IMF Policy Paper*.

50 OECD/G20 2015 Final Report on Action 11 at 98.

Many studies focusing on developing countries do not separate the revenue lost from BEPS behaviours from individual tax evasion and illicit financial flows. Developing countries have higher ratios of CIT to GDP, so their revenue base is potentially more at risk from BEPS behaviours than developed countries, and loss of CIT revenue could lead to critical underfunding of public investment that could help promote economic growth. The Report quotes a report by the African Tax Administration Forum that shows that African tax administrators find that transfer-pricing abuse is a major obstacle not only to effective revenue mobilisation, but also to development and poverty alleviation, and that most countries lack the necessary skills to identify and analyse complex cases. Better understanding of the economic effects of BEPS on developing countries is important for the design of tax policies that account for country differences in tax systems and levels of enforcement capabilities.[51]

It is important in assessing the effectiveness of the BEPS countermeasures to take into account the level of enforcement. Some countries may choose not to enforce certain regulatory rules strongly for tax competitiveness reasons. Other countries may not have the resources or capacity to fully enforce their existing laws and regulations.[52]

A recent working paper by UNCTAD provides a tax and investment perspective on the tax consequences of FDI for developing economies and looked, in particular, at the use of special purpose entities (SPE), tax havens and offshore investment hubs as major players in FDI in developing countries. It found a relatively large effect of SPE and tax haven investment in developing countries.[53] Such a finding implies a greater need in such countries to ensure that they have, and can enforce, anti-avoidance measures.

2.8 FUTURE RESEARCH AND ANALYSIS

The Report also highlights areas for future research and analysis beyond the Action 11 mandate which will add to the understanding of BEPS. These include:[54]

- The prevalence and intensity of BEPS ie how pervasive are BEPS behaviours?.
- Differences in the profitability of MNEs vs. comparable domestic entities.
- Factors contributing to group profitability.
- Factors contributing to affiliate profitability.
- The extent to which non-tax factors affect location decisions.
- The extent of the effects of uncertainty, reputation, compliance costs and disclosures on investment decisions.

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51 OECD/G20 2015 Final Report on Action 11 at 99.
52 OECD/G20 2015 Final Report on Action 11 at 106.
53 OECD/G20 2015 Final Report on Action 11 at 99.
54 OECD/G20 2015 Final Report on Action 11 at 122-123.

- Mobility of different types of labour.
- The impact of Government's strategic behaviours impact countries' co-operative versus competitive behaviours.

2.9 THE IMPACT OF TAX PLANNING

The analysis contained in the Report assesses the fiscal and economic implications of international differences in statutory and effective corporate tax rates and as such it also covers domestic tax incentives. The following points show that tax planning is widespread among MNEs and entails tax revenue losses:[55]

- Robust empirical evidence shows that MNEs engage in international tax planning. MNEs shift profit from higher to lower-tax rate countries. Large MNEs also exploit mismatches between tax systems (e.g. differences in the tax treatment of certain entities, instruments or transactions) and preferential tax treatment for certain activities or incomes to reduce their tax burden.

- Transfer price manipulation, strategic allocation of intangible assets and manipulation of internal and external debt levels are important profit shifting channels.

- The empirical patent analysis suggests that preferential tax treatment of intellectual property influences the location of intangible assets. Preferential intellectual property regimes attract research activities and the ownership of patents invented in other countries. Preferential regimes may also encourage the relabeling of certain incomes to benefit from the regime.

- Tax planning reduces the effective tax rate of large MNEs by 4-8½ percentage points on average. The reduction is even greater for very large firms and firms intensive in the use of intangible assets. Small MNEs also engage in tax planning but to a lesser extent.

- The net tax revenue loss from tax planning is estimated at 4-10% of global corporate tax revenues. These estimates based on 2000-10 data are surrounded by uncertainty and should be interpreted with caution.

- Strict anti-avoidance rules reduce tax planning. Strict anti-avoidance rules, such as transfer pricing, interest deductibility, GAARs and CFCs rules, are found to

[55] OECD/G20 2015 Final Report on Action 11 at 135.

reduce profit shifting. However, complex rules generate compliance costs for all firms, hampering profitability, as well as administrative and enforcement costs for tax authorities. These costs could be reduced by international co-ordination.

The following points show that tax planning effects on economic efficiency are unclear.[56]

- Tax planning may allow certain MNEs to increase their market power, resulting in more concentrated markets. The reduced competitive pressure may entail welfare losses. However, these losses may be partially offset by the associated reallocation of resources to high-productivity MNEs.

- The possibility to manipulate the location of internal and external debt lowers the cost of debt for MNE groups and can compound the "debt-bias" present in most tax systems. Even so, domestic firms have on average higher external leverage than MNE groups. Information on internal debt is not available.

- International tax planning reduces effective tax rates and the effect of cross-country corporate tax differences on the location of investment by tax planning MNEs. However, this is achieved at the cost of additional distortions (e.g. uneven playing field between tax-planning MNEs and other firms) as compared with a situation in which corporate tax rates were cut across the board.

2.10 BEPS COUNTER-MEASURES

In determining measures that could be used to counter BEPS, authors such as Grubert[57] who used a sample of USA corporate tax return data of large non-financial USA MNE's between 1996 and 2002 are cited authoritatively. His paper finds that companies with lower foreign effective tax rates have higher foreign profit margins and lower domestic profit margins. He concludes that the introduction of the US "check-the-box" regulation in 1997, together with research and development, reduces the foreign effective tax rates indirectly indicating that the strategic location of intangible assets can facilitate BEPS.

Others authors like Dharmapala[58] and Dowd, Landefeld, and Moore[59] summarize empirical literature on profit shifting analyses and reports. Dharmapala finds that

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56 OECD/G20 2015 Final Report on Action 11 at 135-136.

57 Grubert H "Foreign taxes and the growing share of U.S. multinational company income abroad: profits, not sales, are being globalized" *National Tax Journal* 65(2) 247-282.

58 Dharmapala D "What do we know about base erosion and profit shifting? A review of empirical literature" *Fiscal Studies* Vol 35 page 421-448.

recently the estimated magnitudes of BEPS are smaller than found in earlier literature. Dowd, Landefeld and Moore on the other hand examined United States tax returns for foreign controlled companies of United States parent MNEs, which they deemed to have non-linear effects of profit shifting.

Reference is also made to databases such as ORBIS and Huzinga and Laeven[60] analysing the Amadeus database of the European Union's MNEs unconsolidated affiliate financial information to investigate profit shifting incentives due to international tax differences.

Thereafter, the OECD Action 11 Report presents an outline of the different approaches adopted in the estimate of profit shifting. There is coverage by country, coverage by MNE, estimated profit variable, tax rate variable and linear and non-linear tax effects *inter alia.* Ultimately, the adopted formula in the Report for the estimate of profit shifting is calculated by:

CIT Revenues Lost from Profit Shifting =

A worldwide responsiveness of profit-to-asset ratio to tax rate differentials *(estimated from the ORBIS database with particular regression on specification for profitable entities -0.1)* ***x average asset/profit ratio*** *(6.2& from ORBIS data)* ***x average tax rate differential*** *(3.6% from ORBIS data)* ***x MNEs' average share of total profits*** *(59% from ORBIS data supplemented with aggregate tax return tabulations for several countries; tax credit as a percentage of before credit-corporate tax collections (19%) from OECD Survey; and an estimate of USD 2.3 trillion of after credit tax collections in 2014 adjusted for expected growth from 2011)* ***x estimated global CIT Revenue***[61]

The formula sets out the key parameters and estimates based on a number of assumptions. Some of the factors lead to an underestimation of revenue losses while others lead to an overestimation of the loss. Additionally the Report makes specific reference to ten empirical analyses of BEPS fiscal effects from various entities like the International Monetary Fund (IMF), United Nations Conference on Trade and Development (UNCTAD), MSCI, the United States JCT economists, Christian Aid, Oxfam, Bach, Clausing, and Vicard.[62]

The IMF estimated the spillover effects of profit shifting and reported an unweighted average revenue loss across all sampled countries at 5% of current CIT Revenue but

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59 Dowd T, Landesfeld P and Moore A "Profit shifting on U.S. multinationals" *Joint Committee on Taxation Working Paper*.

60 Huzinga H and Laeven L "International profit-shifting within multinationals: A multi-country perspective" Journal of Public Economics 88(6) Page 1149 – 1168.

61 OECD/G20 2015 Final Report on Action 11 at 102.

62 OECD/G20 2015 Final Report on Action 11 at 104.

almost 13% in the non-OECD countries.[63] The study unfortunately assumes that all the variation in cross-country CIT efficiency ratios is attributable to profit shifting. UNCTAD on the other hand estimates revenue losses for developing countries due to profit shifting to range from USD 66 billion to USD 122 billion in 2012.[64] Christian Aid and Oxfam conclude that Trade Mispricing in non-EU countries and developing countries reducing tax revenues at USD 122 billion and USD 11billion respectively.[65]

On BEPS countermeasures, the Report also notes that several studies have been conducted on it providing insight into the scale of the particular BEPS channel. In assessing the effect of BEPS countermeasures, it is important to take into account the different levels of enforcement. In some instances countries may choose not to enforce certain regulatory rules strongly for tax competitiveness reasons while others may not have the resources and capacity to fully enforce their existing laws and regulations.[66]

Five BEPS countermeasures are discussed, making specific reference to the BEPS Actions embodying them, and some of the studies exploring them to various degrees. These are:

i) **Neutralising the effect of hybrid mismatch rules** as reflected in **Action 2** and canvassed by authors like Grubert[67] together with the OECD Analysis in Annex 3.A1.

ii) **Strengthening CFC Rules** through **Action 3** and embracing the study of Ruf and Weichenrieder[68] who examined the German Micro-database Direct Investment (MiDi) on German MNEs to investigate the effect of the German CFC legislation change that had arisen in response to a decision by the European Court of Justice. Others such as Markle and Robinson[69] use ORBIS and COMPUSTAT data to investigate whether CFC Rules, bilateral investment treaties and withholding taxes affect the behaviour of MNEs.

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63 IMF (2014), "Spillovers in International Corporate Taxation", *IMF Policy Paper*, International Monetary Fund.

64 UNCTAD (2015), "FDI, Tax and Development, The fiscal role of multinational enterprises: towards guidelines for Coherent International Tax and Investment Policies", *Working paper for review and feedback, 3/26/2015*.

65 Oxfam (2015), "Africa: Rising for the few", www.oxfam.org/sites/www.oxfam.org/files/world_economic_forum_wef.africa_rising_for_the_few.pdf.

66 OECD/G20 2015 Final Report on Action 11 at 106.

67 *Supra.*

68 Ruf M and Weichenrieder A.J. "CFC legislation, passive assets and the impact of the ECJ's Cardbury-Schweppes decision" *CESifo Working Paper No.44*61.

69 Markle K.S and Robinson L (2012) "Tax haven use across international tax regimes".

iii) **Limit Base Erosion via interest deductions** proposed in **Action 4** cemented by several studies that have found that MNEs' strategic placement of debt and associated interest deductions are sensitive to tax differentials and tax interest limitations.[70]

iv) **Prevent Treaty Abuse** as enunciated by **Action 6** and an acknowledgement that empirical analyses of tax treaties are limited and often included with other BEPS behaviours, or with specific reference to particular countries. The Report does speak to the simulation analysis conducted by Van't Reit and Lejour[71] showing the potential reduction in withholding taxes due to treaty shopping, although the analysis is not based on actual taxpayer behaviour.

v) **Assure that Transfer Pricing outcomes are line with value creation** as reflected in **Actions 8 to 10.** Undoubtedly OECD Action 11 Report highlights that Transfer Pricing has been identified as a key area in BEPS studies with four Actions dedicated to addressing BEPS through this channel. Studies from as early as 2003, demonstrating an increase in inter-affiliate or inter-company transactions shows the tendency of BEPS-like behaviour in transfer pricing. Mutti and Grubert[72] analyse United States MNE tax return data to investigate whether their "check-the-box" regulation has encouraged the relocation of intangible assets abroad. The study reveals evidence of substantial migration of intangible assets abroad in particular to low tax countries.[73]

vi) **Benefits of better disclosure** catered for by **Actions 5, 11, 12 and 13.** The Report makes specific reference to a paper by Dyreng, Hoopes and Wilde[74] which has evidence suggesting that UK public companies decreased tax

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70 See Desai, Foley and Hines (2004) that undertook a survey to identify the determinants of the capital structure of foreign affiliates in the United States MNEs. They find that higher tax rates increase the use of both external and internal debt for United States foreign affiliates, with more intense effect of internal debt. Huzinga, Laeven and Nicodeme (2008) use the European Amadeus database to test whether differences in taxation among countries have a statistically significant effect on the firm's capital structure and internal debt.

71 Van't Reit M and Lejour A "Ranking the stars: Network analysis of bilateral tax treaties" *CPB Discussion Paper No 290*.

72 Mutti J and Grubert H (2009) "The effect of taxes on royalties and the migration of intangible assets abroad" in Reinsdorf M and Slaughter M (ed.) *International trade in Services and Intangibles in the Era of Globalisation*, University of Chicago Press.

73 See OECD/G20 2015 Final Report on Action 11 in para 209 on a more recent 2012 study by Karkinsky and Riedel which merges from Amadeus financial statement database and PATSTAT information to examine MNE patent applications in Europe. They find that low tax rates increase the probability that MNE apply for patent boxes in low tax locations.

74 Dyreng S, Hoopes J.L and Wilde J.H "Public Pressure and corporate tax behaviour" *Working Paper*.

avoidance when there was increased public disclosure. The same sentiments of reduced profit shifting were found in a study by Lohse and Riedel[75] where more stringent transfer pricing documentation was put in place.

As a more general observation, the Report notes that some corporations are already changing their international tax structures due to the progress of the BEPS Project and expected change by government.[76] Further that studies show positive effects of current unilateral measures shifting BEPS behaviour away from countries with anti-avoidance rules towards countries without anti-avoidance rules.[77]

2.11 TOOLKIT

When countries consider introducing BEPS countermeasures, estimates of the fiscal and economic effects may be needed. Tax policy analysts can provide government officials and other stakeholders with evidence-based analysis of the fiscal and economic effects of options to curtail BEPS behaviours.

Annex 3.A2[78] provides government tax administrations and tax policy officers, as well as other stakeholders, with a toolkit of methodological approaches that could be used to estimate the fiscal effects of BEPS countermeasures.

The annex provides potential approaches that could be used by government tax policy analysts to estimate the fiscal effects of BEPS countermeasures for their respective countries. A general approach is described before potential approaches are explained for the individual BEPS Actions. The proposed methodologies are set out according to the individual countermeasures of the BEPS Actions. Some methodologies are more comprehensive than others, given the variation in data availability; the extent of insights from empirical studies; and depending on the design of the countermeasures.

Countries will have different datasets and some may be more useful for particular BEPS countermeasures than others. It is recognised that estimating the fiscal effects of BEPS countermeasures may rely on applicable tax return data, financial account micro-data, macro-data (aggregated from tax return or financial accounts), a combination of micro

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75 Lohse T and Riedel N "The impact of transfer pricing regulations on profit shifting within European multinationals" *FZID Discussion Paper* No. 61-2012.

76 OECD/G20 2015 Final Report on Action 11 at110.

77 OECD/G20 2015 Final Report on Action 11 in Annex 3.A1 analysis provides a more detailed analysis of unilateral measures by combining different five (the report erroneously says four) anti avoidance measures being different transfer pricing documentation levels, different levels of interest limitations, the presence of CFC rules, the presence of General Anti-Avoidance Rules and the levels of withholding tax taking into account tax treaties.

78 OECD/G20 2015 Final Report on Action 11 at 193.

and macro-data sources, or in some cases to data analogous to the country. Where possible, multiple approaches based on different sources of data are described. Some countries have estimated the fiscal effects of BEPS-related countermeasures enacted or proposed.

The Annex considers that as better data becomes available (both as a result of CbCR and countries recognising the need to draw on taxpayer micro-data to make more informed and evidence-based tax policy decisions) tax policy analysts will be in a better position to evaluate and monitor trends in BEPS behaviours and the effect of countermeasures. An important consideration is the evaluation of *ex post* estimates relative to *ex ante* estimates. Separating the effects of unexpected macroeconomic changes from unexpected taxpayer behaviours from technical estimation issues can provide valuable learning to tax policy analysts as they assess the underlying causes in cases of large differences. Even small differences do not necessarily mean that all assumptions *ex ante* were correct. Evaluation of past estimates can improve understanding of key parameters, including behavioural changes.

3 RECOMMENDATIONS

Based on the aforegoing, the Report makes the following recommendations:

Recommendation 1

The OECD should work with all OECD members, BEPS Associates and any country willing to participate to publish on a regular basis, a new Corporate Tax Statistics publication, which would compile a range of data and statistical analyses relevant to the economic analysis of BEPS in an internationally consistent format. Among other information this publication will include aggregated and anonymised statistical analyses prepared by governments based on data collected under Action 13 Country-by-Country Reports.[79]

Unlike some of the other recommendations discussed below, Recommendation 1 doesn't arise from only one specific Chapter of the Action 11 Report but from various aspects of the Report. Chapter 1 on assessment of existing data sources enables this Recommendation because it concedes that there is a deficit in the precision and comprehensiveness of the currently available data. It is therefore understandable why this particular recommendation, advocating for consistency and the compilation of a range of data relevant to the economic analysis of BEPS can arise.

[79] OECD/G20 2015 Final Report on Action 11 at 262.

The Report divides the currently available data along the lines of macro data sources and micro data sources. With the former, these include national accounts, balance of payments, foreign direct investment (FDI), trade, corporate income tax revenue, and customs data. With the latter, currently available BEPS data includes company financial information from public or proprietary databases, company financial information from government databases, tax return CIT information, tax audit information, and detailed specific tax company information.

Various difficulties arise with the currently available data such as the underlying notion that BEPS activities are intertwined with real economic activities reflected in FDI, national accounts and balance of payments on a macro level; to different reporting requirements, strict rules limiting reported information, and the protection of confidential tax payer information on the micro level.

Since the proposed indicators of BEPS emerge as a direct consequence of the data available, the discussion on indicators of BEPS is consequently indirectly relevant to this recommendation. However, since an incontrovertible link exists between the discussion on Indicators and Recommendation 3, the lucid discussion on Recommendation 3 below specifically explores the current and proposed indicators thus no further mention is required here save as to highlight that the comprehensiveness of the available data has an impact on one's dexterity to effectively use the indicators.

The OECD Report briefly examines the economic impact of BEPS and advocates for the introduction of measures to ensure the effectiveness of BEPS countermeasures.[80] The publication of a new Corporate Tax Statistic as recommended herein would facilitate a better assessment of the economic analysis of BEPS in an internationally consistent format. This position is reiterated in Annex 3.A2 to the Report which is the toolkit for estimating the country-specific fiscal effects of BEPS countermeasures. The Annex further expresses the need for publication such as the one recommended herein as important sources of information.

Moreover, the Recommendation falls squarely within the parameters of the intricately woven golden thread that has already been highlighted above. This recommendation, if successfully implemented, effectively improves the tools and data available to measure BEPS because it is geared to compile a range of data and statistical analyses in an internationally consistent format thereby augmenting the mandate of Action 11. The Recommendation also makes a direct reference to Action 13 on the Country-by-Country Reports which also have the potential to significantly enhance the economic analysis of BEPS. The OECD's Action 11 Report however concedes that despite Action 13 and the

[80] See Chapter 3 of the OECD/G20 2015 Final Report on Action 11.

new proposed publication under recommendation 1, it may still prove challenging to separate BEPS from real economic activity.

Recommendation 2

The OECD should work with all OECD members, BEPS associates and any willing participating governments to produce periodic reports on estimated revenue impacts of proposed and enacted BEPS countermeasures.[81]

This recommendation comes on the backdrop of an extensive discussion on BEPS related literature from several astute authors. Despite their extensive accounts, it is conceded that most of the studies are limited to a single country (such as Germany or the United States of America) or an MNE headquartered in a single country where company surveys, corporate tax returns and company trade data are made available to researchers on a confidential basis.

Recommendation 3

The OECD should continue to produce and refine analytical tools and BEPS Indicators to monitor the scale and economic impact of BEPS and to evaluate the effectiveness and economic impact of BEPS countermeasures.[82]

As indicated earlier, the OECD Action 11 Report advocates for the use of the indicators because they can be calculated historically on an annual basis to track direct changes in BEPS over time as well as make future calculations once more accurate and comprehensive data is made available.[83] Further, it is provided that the said indicators can be updated relatively quickly from data that is available on a timely basis.[84] It should be noted that Recommendation 6 below specifically targets the data relevant for Future Indicator B (foreign operations and differential rates of return on FDI investment from special purpose entities); this doesn't however suggest that such data would not be valuable for the other indicators. It could in fact be used to give better results for Indicator 1.[85]

Recommendation 4

Governments should improve the public reporting of Business Tax Statistics particularly for MNEs.[86]

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81 OECD/G20 2015 Final Report on Action 11 at 263.
82 OECD/G20 2015 Final Report on Action 11 at 263.
83 See para 2.5 above.
84 *Ibid.*
85 *Ibid.*
86 OECD/G20 2015 Final Report on Action 11 at 264.

Recommendation 4 has inherent similarities to Recommendation 1 except it is not on the international plane. The request here is for governments to internally improve the public reporting of business statistics particularly in relation to MNEs. The direct referral to MNE's is not unusual because the issue of BEPS and BEPS activities is rooted on the existence of MNEs which unscrupulously implement artificial corporate structures to reap from the benefits of double non-taxation or single digit taxation.[87]

Governments are therefore requested and encouraged under Recommendation 4 to enhance and refine their public reporting.

It flows from the discussion in existing data sources[88] relevant to BEPS analysis that the inclusion of improved Business Tax Statistics advocated by this recommendation will yield better results. In fact, the improved Business Tax Statistics will add to the fabric of BEPS data and ultimately BEPS jurisprudence after analysis and critique by astute academics, researchers, tax policy officials, tax administrators *inter alia* as advocated in Recommendation 6.

The OECD report acknowledges the administrative burden that this places on government.[89] Despite the insufficiencies in the currently available data, government does still need to collect and compile copious amounts of data. It is submitted that the recommendation does necessarily require an increase in the quantity of the data collected but in the quality. Undoubtedly improving quality may inadvertently lead to an increase in quantity but that should not be understood to be the primary aim of this recommendation.

Recommendation 5

> *Governments should continue to make improvements in non-tax data relevant to BEPS such as the broadening country coverage and improving data on FDI associated with resident special purpose entities, trade in services and intangible investments.*[90]

Similarly, the recommendation has no overt link to any of the other recommendations. This recommendation refers to the measurement of intangible investments including the capitalisation of investments in research and development as this will enable researchers to better identify the contributors to profitability and the scale of their contribution.

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87 OECD/G20 2015 Final Report on Action 11 at 82.
88 See paras 2.1 and 2.2 above.
89 See para 2 above and OECD/G20 2015 Final Report on Action 11 at 250.
90 OECD/G20 2015 Final Report on Action 11 at 264.

Specific reference is made to *Benchmark Definition of Foreign Direct Investment 4th Edition*[91] which recommends that countries should include transactions with special purpose entities in their FDI statistics to ensure comparability with other countries. These refined statistics enable policymakers to assess the impact of FDI into their economies because the statistics will better reflect FDI into businesses with a real presence in the economy.

With regards to the discussion of future indicators, Future Indicator B (foreign operations and differential rates of return on FDI investment from special purpose entities) will emerge directly as a consequence of the availability of the data recommended herein. This information will also assist in the key objective of differentiating between BEPS activity and genuine economic activity.

Recommendation 6

> *Governments should consider current best practices and explore new approaches to collaborating on BEPS research with academics and other researchers. Governments should encourage more research on MNE activity within tax administrations, tax policy officials, national statistical offices, and by academic researchers, to improve the understanding of BEPS and to better separate BEPS from real economic effects and non-BEPS tax preferences.*[92]

This Recommendation is the final touch to the entire Report and aims to capture all the central tenets and stakeholders in the successful implementation of measuring and monitoring BEPS. It is therefore covered by various aspects of the Action 11 with no stand-alone akin to the one demonstrated in Recommendation 3.

Firstly the Recommendation encourages governments to consider current best practices and explore collaborate efforts between the various stakeholders. This request is not a standalone in isolation from the Action 11 OECD Report but in fact summarises it together with the recommendation aptly. In all the previous Recommendations the underlying aim is to improve the available data and tools to monitor the said data, this Recommendation seals it up by encouraging that such efforts be done in a collaborative fashion.

The second aspect speaking to the involvement of academics and researches is also reflected throughout the entire text of the Report. For example the discussion on countermeasures in Recommendation 2 involves many key studies conducted by various academics in different jurisdictions. The concern expressed therein is that most

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91 *Benchmark Definition of Foreign Direct Investment 4th Edition (2008).*

92 OECD/G20 2015 Final Report on Action 11 at 265.

information relevant to a comprehensive BEPS analysis is confidential and therefore sometimes inaccessible. As noted in the above discussion the studies effectively have a lacuna disenabling them from getting a more thorough understanding of BEPS and a better separation of BEPS activities from real economic effects. These deficits result in BEPS studies being merely illustrative and not definitive. These sentiments are echoed in this Recommendation with a request that governments should encourage further research not only to academics and researchers but also to tax administrators, national statistical offices and tax policy officials.[93]

4 THE DAVIS TAX COMMITTEE RECOMMENDATIONS ON ACTION 11

The Davis Tax Committee considers that it is essential for South Africa to measure the scale and economic impact of BEPS in South Africa. It is acknowledged that so far there is no measuring and monitoring system for BEPS in South Africa and, therefore, the scale of BEPS and the economic impact thereof are not known. As such it is impossible to determine whether more or less resources should be placed towards the curbing of BEPS.

The recommendations made by the OECD, in this regard, mainly place on governments the obligation to enhance the collection and maintenance of information that would help determine the extent of BEPS and therefore the economic impact of BEPS. In the absence of a monitoring and measuring system for BEPS in South Africa, it is recommended that South Africa should adopt the recommendations of the OECD in developing the monitoring and measuring system.

It is noted that Recommendation 3 of the OECD places an obligation on the OECD to "*continue to produce and refine analytical tools and BEPS indicators to monitor the scale and economic impact of BEPS and to evaluate the effectiveness and economic impact of BEPS countermeasures".* This recommendation places no obligation or expectation of action on the governments, therefore no recommendation is made in that regard. Along with the other recommendations of the OECD, the DTC therefore recommends that:

1. South Africa works with the OECD to publish, on a regular basis, a new Corporate Tax Statistics publication, which would compile a range of data and statistical analyses relevant to the economic analysis of BEPS in an internationally consistent format. This publication could include aggregated and anonymised statistical analyses prepared by the National Treasury based on data collected under Action 13 Country-by-Country Reports. South Africa already publishes comprehensive data on tax collections by segment of

[93] OECD/G20 2015 Final Report on Action 11 at 265.

taxpayer, which is to be complimented. It has the systems in place to determine much more from the information that can be collected via tax returns. It is therefore recommended that that South Africa publishes a new Corporate Tax Statistics report in line with this OECD Recommendation.

2. South Africa works with the OECD to produce periodic reports on estimated revenue impacts of proposed and enacted BEPS countermeasures.
3. The South African government improves the public reporting of Business Tax Statistics particularly for MNEs.
4. South Africa continues to make improvements in non-tax data relevant to BEPS such as the broadening country coverage and improving data on FDI associated with resident special purpose entities, trade in services and intangible investments.
5. South Africa considers current best practices and explores new approaches to collaborating on BEPS research with academics and other researchers. The government could encourage more research on MNE activity within the South African Revenue Service, the National Treasury, Statistics South Africa and by academic researchers, to improve the understanding of BEPS and to better separate BEPS from real economic effects and non-BEPS tax preferences.