cutting through complexity

Tax morality and tax transparency: an overview

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FOREWORD

Tax directors around the world are shouldering the impact of fundamental changes in attitudes and approaches to tax. For many, the days are gone when tax was solely an expense to be managed. Whether it is corporate social responsibility, tax governance, enhanced transparency with tax authorities, investors, or society holding individuals and businesses accountable for paying a fair amount of tax, these issues are subject to increasingly heated debates.

Corporate reputation management has always been an issue for large global companies. Now tax and the issue of paying your fair share is one of the most prominent areas being scrutinized by governments, the general public and, to a great extent, the media. Just like corporate responsibility and environmental issues, brand enhancement or damage can occur if there is perception that a company's tax affairs are overly aggressive or 'unfair'.

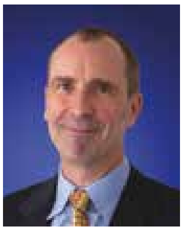
As the public looks to businesses to 'do the right thing', expectations for more transparency are increasing. We expect the trends will continue toward more transparency between taxpayers and the tax authorities, and more disclosure by public companies as to the amount of their tax payments and where those taxes are being paid.

On the other hand, tax systems have not kept up with changes in business models and practices, so there is room for improvement. And, countries often use their tax systems to compete for investment dollars and jobs, and to benefit the foreign activity of their own multinationals. Much of the current debate stems from this reality.

This paper asks four questions:

1. What are the underlying factors driving the international debate?
2. What is the story so far?
3. What are the areas of focus and likely future developments?
4. How does a company director, senior executive or advisor best respond?

With reputations at stake, ultimately for senior business leaders it will be a question of watching the developments and planning for a potential dialogue with all stakeholders on their tax matters.



Greg Wiebe
KPMG's Global Head of Tax

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FACTORS DRIVING THE DEBATE

The confluence of five streams

We are at the confluence of five powerful streams. These streams are largely structural rather than temporary.

> "Coverage of the inadequacies of Greek revenue collection, the effective tax rate of US Presidential Candidate Mitt Romney, the activities of UK Uncut and more recently, the former French Budget Minister's reported evasion activities have kept taxation in the news spotlight."

1 Post global financial crisis (GFC) revenue and expenditure

The new economic realities faced by governments around the world mean that significant tax reforms are taking place. As governments look to recoup lost revenues from the economic downturn, the entire world is in the midst of a period of considerable change with their taxation regimes. A large number of countries are considering, or are in the process of implementing, substantial reforms of their tax systems.

This has given rise to additional focus on tax payable by companies and high net worth individuals by politicians and public officials seeking to strengthen a weak fiscal position.

That focus is enhanced by a general public impression, particularly in Europe and the US, that large companies and banks caused the crisis and that they should be the first port of call for revenue, rather than the person on the Clapham omnibus, the Parisian RER, the Metro de Madrid or the Cleveland RTA.

2 Rise of corporate social responsibility

The second stream is the rise and broad acceptance of Corporate Social Responsibility (CSR) in the last decade. This movement seeks to integrate a broad social agenda into the purview of business operations.

While diversity and sustainability have been the vanguard of CSR, anti-corruption and tax arguably constitute the next wave.

3 Rise of media focus

The third stream is the rise of media focus, including social media power and the entrance of many not-for-profit organizations into the taxation realm. Coverage of the inadequacies of Greek revenue collection, the effective tax rate of US Presidential Candidate Mitt Romney, the activities of UK Uncut and more recently, the former French Budget Minister's reported evasion activities have kept taxation in the news spotlight.

This has had two effects:

- First, it has changed the nature and impact of reputational risk associated with tax matters. There is now more at stake. Tax has become an 'operational business' issue for some, no longer limited to its domain in the finance area of a major corporate.
- Second, it has placed tax into a level of discussion which is not attuned to its nuances and complexities. This makes discussion far more difficult.

4 Internationalization of business

The fourth stream is the increasing internationalization of business. This is not simply a question of capital mobility, but of longer, more specialized and more international supply chains.

Those supply chains increasingly separate intellectual property, marketing capacity and support services into jurisdictions which are neither in the country of residence of the ultimate group holding company nor in the country where the customers or the primary tangible factors of production are located.

5 Increasing use of the internet

Strongly related to increasing internationalization of business, is the final stream, which is the increasing use of the internet for sales and services. Sellers often do not have a physical presence where the transaction is initiated. This has given rise to a discussion of whether the standard tax treaty model of more than 60 years standing continues to be appropriate in a digital environment.

THE STORY SO FAR... TAX MORALITY

"...businesses who think they can carry on dodging [their] fair share... well they need to wake up and smell the coffee, because the public who buy from them have had enough."

UK Prime Minister, David Cameron
World Economic Forum,
Davos Switzerland, January 2013

OCTOBER 2010

Greek sovereign debt crisis fallout

While the heightened discussion of tax morality and transparency in recent times has many sources, a significant one concerns the media attention given to the causes of the Greek sovereign debt crisis.

A University of Chicago report estimated that tax evasion by self-employed professionals alone was EUR28 billion or 31 percent of the budget deficit for that year. (See Artavanis, Morse, Tsoutsoura, *Tax Evasion across industries: Soft credit evidence from Greece*, 2012).

The fact that the European Central Bank and the IMF provided approximately EUR150 billion in bailout loans to Greece (out of a current cumulative total of about EUR240 billion) focused attention on comparative tax ethics of various systems throughout Europe and elsewhere.

This original discussion of individual tax evasion spread in multiple directions, including the use of Swiss bank accounts and offshore holding companies by Greek and other European citizens.

UK Uncut and high street action – Part 1

While Greece involved tax avoidance and the illegal publication of tax data, this focus received a transformation elsewhere in Europe and particularly in the UK. In October 2010, a group of activists formed an organization called UK Uncut which was an anti-austerity direct action group.

While their focus was much broader than taxation, they initially organized protests against a major telecommunications company (which had recently settled a tax dispute in the UK) and a group holding a series of high street stores (which, it was asserted, paid virtually no tax).

UK political dimension

This took on a political dimension of its own with a series of high profile entertainers faulted for their involvement in tax avoidance schemes and the Prime Minister David Cameron and Chancellor George Osborne denouncing such behavior as "morally wrong".

OCTOBER 2012

Double Irish Dutch Sandwich

In late October 2012, the international financial media began to discuss and explain the 'Double Irish Dutch Sandwich'.

This concept had been used in tax literature since at least 2007, but took on a significant prominence in late 2012 as an example of how large multinationals can structure their affairs to direct profits into low or no tax jurisdictions.

DECEMBER 2012

UK Uncut and high street action – Part 2

In December 2012, UK Uncut launched a campaign against a major coffee retailer on the basis of the small amount of tax it had paid in the UK relative to its very large sales.

The retailer responded by indicating that it had listened to its customers and that it would pay approximately EUR10 million of tax in each of the income years, 2013 and 2014, whether it was profitable or not.

This was coupled with other profiles in the press on internet retailers and a search engine company.

> "... the traditional concept of legality being the appropriate delineation of what is acceptable and what is not is changing. The reputational question, as vague as it may be, is coming to the fore..."

SHIFTING GOAL POSTS

Are we experiencing parameter changes or shifting goal posts on international taxation? Yes.

- For many, tax is becoming a governance and reputational issue.
- The traditional concept of legality being the appropriate delineation of what is acceptable and what is not is changing. The reputational question, as vague as it may be, is coming to the fore.
- There is momentum to change the rules of international taxation that have been embedded for more than 60 years.

JANUARY 2013

David Cameron in Davos

In January 2013, the UK Prime Minister, David Cameron, presented to the World Economic Forum in Davos and used that opportunity to indicate that tax minimization would be placed on the G8 agenda.

He said, "businesses who think they can carry on dodging [their] fair share, or that they can keep on selling to the UK and setting up ever more complex tax arrangements abroad to squeeze their tax bills right down, well they need to wake up and smell the coffee, because the public who buy from them have had enough."

France – The Collin & Colin report

Also in January, the French Government released a report they had commissioned by Pierre Collin and Nicholas Colin on international taxation in the digital environment.

They concluded that the concept of 'permanent establishment' needed to be changed under international tax treaties to acknowledge that users of the internet were real creators of value. Such a system, it was acknowledged, could only be introduced with wide international consensus and the report pushed governments to seek that consensus in the OECD, G8 and G20 forums.

In the meantime, it was suggested it may be appropriate for the French Government to introduce a tax on the transfer of data to certain non-resident providers of services. This is essentially the concept of a "bit or byte tax".

In addition, the Dutch Parliament has been debating the role of the Netherlands in international tax structuring, with some Parliamentarians suggesting that Dutch tax rules which promote international holding companies may be inappropriate.

FEBRUARY 2013

Addressing Base Erosion and Profit Shifting – Part 1

On 1 February 2013, the OECD released a report titled Base Erosion and Profit Shifting (BEPS). BEPS refers to the reduction or transfer of economic activities and consequential reduction in profits out of a country. This was released in advance of a G20 Finance Ministers meeting where the UK, France, Germany and Australia called for global action on taxation matters to tackle base erosion.

The US has seen multiple debates on the need for tax reform in recent years at various levels of sophistication. The election campaign saw considerable focus on Presidential Candidate Mitt Romney's personal tax affairs, his effective tax rate and the reasons for that rate.

MARCH 2013

Business and Industry Advisory Committee (BIAC) – participation and dialogue

On 26 March 2013, to further collaboration and dialogue with stakeholders, the OECD met and consulted with BIAC bringing together business representatives, government and others to address the international tax issues outlined in the OECD BEPS report.

Attendees included representatives from the OECD, the European Commission, specialists from KPMG and other professional services firms, as well as government representatives from Canada, Denmark, France, Germany, India, Ireland, Italy, Luxembourg, Netherlands, Norway, Spain, UK and US.

The OECD has organized the BEPS project around three work clusters that are chaired by officials from key member countries: Countering Base Erosion, chaired by Germany, Jurisdiction to Tax, co-chaired by France and the United States, and Transfer Pricing, chaired by the United Kingdom.

Prior to the meeting, the OECD provided BIAC with a list of questions (OECD Questions) to address in the consultation. The OECD Questions were divided into two parts: one, general and two, questions arranged along the same lines as the three work clusters.

The OECD is now working to develop a Global Action Plan for the BEPS project, which with approval by the OECD Committee on Fiscal Affairs, will be delivered to G20 Finance Ministers in July for their endorsement.

THE STORY SO FAR… TRANSPARENCY

> As the data released now carries search functions, many complain of the breach of privacy arising from tax snooping.

MAY 2008

Personal tax transparency

Norway, Sweden and Finland have for many years published data on individual taxpayers, level of income and tax payments. This has led to the creation of "Top 10" lists by the media. As the data released now carries search functions, many complain of the breach of privacy arising from tax snooping.

On 1 May 2008, in the last days of the Romano Prodi Government, the Italian National Tax Office published on its website the earnings and taxes paid by 38 million taxpayers from 2005 (in alphabetical order) by region.

The website lasted only a few hours before it crashed from overuse. It was subsequently closed by the Italian Privacy Office, but not before the details of a number of high profile personalities were published by the press. The Italian Finance Minister responsible for releasing the data did so to highlight the level of avoidance within the country. The action was strongly criticized on the basis that such personal details could lead to greater criminal extortion.

OCTOBER 2010

Name and shame

In October 2010, Christine Lagarde, the former French Finance Minister (and now Managing Director of the IMF), released to the Greek Government a list of approximately 2,000 names of individuals who had deposits with the Geneva branch of a major bank (out of a total of 130,000 names that the French police had obtained).

Protesting against the Greek Government's failure to launch an investigation, a Greek weekly published the list. This led to the editor of the publication being charged with a criminal offence, for which he was acquitted.

JUNE 2012

'Open Tax Lists' in Denmark

On 13 June 2012 the Danish Parliament passed laws requiring the publication of the amount of tax paid by all companies in Denmark. These have been referred to as 'Open Tax Lists' and are published on the Danish Revenue's website.

The information disclosed is the level of taxable income, utilized tax losses, the estimated tax payable for the year and the type of tax – whether it is ordinary income tax, co-operative tax or tonnage tax. The level of revenue is not disclosed. Also the information disclosed is replaced every year and historical details of tax paid are not contained on the website.


Page 3 /11
FY END DECEMBER 2005
Cashflow/net inc
Payout ratio
Debt to assets
T debt/Com eqty
Tot inv/assets
Tot inv/liab
Loss ratio NL
Expense ratio NL
Combined ratio
Res to assets
Eq & RE inv/inv
Net prem/Equity

PERSONAL TAX INFORMATION OF PUBLIC OFFICIALS

Since the early 1970s, it has become traditional in the United States for American presidents to release their personal tax returns or at least a statement of their taxation position. Indeed the personal tax returns of the US presidents going back to Richard Nixon's 1969 return are available on the internet.

In more recent times this public demand for openness has moved to the level of presidential candidates. Candidate Mitt Romney was moved to release income tax returns and provide a summary of his tax affairs going back to 1990. This was subject to significant political scrutiny and occasional public debate.

In the 2012 London Mayoral elections, all three candidates were moved to release their personal income tax returns and there has been considerable political debate on whether the UK should embrace greater publication of general tax information.

APRIL 2013

Australia's approach

On 3 April 2013 the Australian Assistant Treasurer, David Bradbury, released a Discussion Paper on various transparency proposals including disclosure of taxes paid by corporate entities with an annual income of greater than 100 million Australian dollars (AUD), or with a Minerals Resource Rent Tax (MRRT) or Petroleum Resource Rent Tax (PRRT) liability.

The proposed rules apply to corporate entities with either a 'reported total income' of AUD100 million or more; or a MRRT or PRRT liability in a year (irrespective of income). Reported total income is the entity's total gross income for accounting purposes. It includes exempt and foreign sourced income and extraordinary gains. It is broader than ordinary and statutory income and turnover. While it is not completely clear, it would seem that resident corporate entities will disclose world-wide income and non-residents only Australian income.

For corporate entities with a reported total income over AUD100 million it is currently proposed the Commissioner will publish (probably on the ATO website): the name, ABN, reported total income, taxable income and income tax payable. A tax loss or nil tax will be reported as not having taxable income. For MRRT and PRRT taxpayers, only the name, ABN and liability will be published.

The proposal would apply from 2013-14 income year and years starting after 1 July 2013 for MRRT and PRRT. The information is based on an entity's tax returns and thus taxpayers will not be required to provide additional information to the Commissioner.

There is clear potential for public misunderstanding and misleading comparisons when this information is provided in its raw form. The raw data will not take into account foreign taxes, tax losses, tax offsets, timing differences, consolidated tax returns including multi-entry consolidated groups, and stapled structures.

Also the raw data does not take into account payroll tax, stamp duty, excise, levies and other taxes.

Accordingly, large corporates need a strategy to explain their tax information and be prepared to respond to public commentary based on the released information.

Other countries are watching this Australian development closely.

INTERNATIONAL RESPONSES

Dodd-Frank Act in the US

SEC registered companies in the extractive industries to disclose payments of taxes, royalties, fees, bonuses, dividends and infrastructure payments, that are not *de minimis* in nature made after 30 September 2013.

EU expansion of transparency disclosures

The EU is currently considering proposals to expand disclosures of taxes, royalties and similar payments not only in the extractive industries, but to projects in the forestry, construction, telecommunications and other sectors.

Extractive industries transparency initiative

Voluntary framework involving over 70 mining, oil and gas companies who report on taxes, royalties, production entitlements, fees and bonuses and similar payments in the material jurisdictions in which they operate.

Rise of Foreign Account Tax Compliance Act (FATCA)

FATCA requires non-US financial institutions to identify and disclose the account holders' names, addresses, balances, receipts, and withdrawals for certain US citizens. As a way to foster compliance: if the foreign financial institution does not comply, then payers making payments to the non-compliant foreign financial institutions are required to withhold 30 percent of the gross payments.

A number of countries including the UK, Mexico, Denmark, Ireland, Switzerland, Spain and Germany have entered into agreements with the US involving management of this exchange of information. Many more countries, including Australia, will enter similar agreements in the future.

On 9 April 2013, the UK, France, Germany, Italy and Spain agreed to develop and pilot a multilateral tax information exchange. Under this agreement, a wide range of information will be automatically exchanged between the five countries in a manner similar to the FATCA exchanges with the US.

> "Increasing the transparency of tax payable will enable the public to better understand the corporate tax system and engage in policy debates, as well as discourage aggressive tax minimization practices by large corporate entities."

Australian Assistant Treasurer, David Bradbury, 3 April 2013

LIKELY FUTURE DEVELOPMENTS

> "One can expect a myriad of scoping documents, discussion papers and communiqués at the country, secretariat and forum levels."

There are a large number of international meetings involving the EU, OECD, G8, G20 and BRICS (Brazil, Russia, India, China and South Africa) where tax will be on the agenda. These meetings may involve Revenue Heads, Finance Ministers or Country Leaders. Some will be more focused on evasion, others on international tax rules.

One can expect a myriad of scoping documents, discussion papers and communiqués at the country, secretariat and forum levels.

The main path will be the release in July 2013 by the Committee of Fiscal Affairs (CFA) of the OECD of a draft comprehensive action plan dealing with BEPS. The CFA has given a mandate to work with the OECD Secretariat, a myriad of working groups and specific countries in the formulation of such a plan.

Press coverage has suggested that the UK will focus on transfer pricing; Germany, on base erosion; and France and the US on the problem of identifying the correct jurisdiction to tax in the current internet-based business environment. However, the report is also likely to draw on preliminary work of the G8 and the outcome of the Tax Commissioner's Forum in Moscow in May 2013.

Importantly the report of the CFA of the OECD will feed into the G20 agenda which is rapidly becoming the world's premier international forum. There will be a meeting in July 2013 of G20 Finance Ministers in Moscow which is likely to discuss the action plan presented by the OECD.

The G20 agenda is largely determined by three of the countries, being past, present and future hosts. The three countries include Mexico (2012), Russia (2013) and Australia (2014). Mexico will drop off next year and Turkey (2015) will join. Australia's role in chairing the G20 summit in 2014 and setting the agenda in advance will be a critical piece in any developments on base erosion and profit shifting.

OECD ACTION PLAN – LIKELY FOCUS AREAS

1. Changes to transfer pricing rules, particularly on intangibles
2. Solutions as to who has the jurisdiction to tax – especially on internet transactions
3. Instruments to neutralize hybrid mismatch arrangements
4. Rules on general anti-avoidance regimes
5. Rules on controlled foreign corporation regimes
6. Rules on intra-group financing and derivatives
7. Changes to limitation of benefits and anti-treaty abuse provisions
8. Solutions to counter preferential taxation regimes
9. Additional transparency measures
10. Promotion of multi-lateral co-operation

> The main recommendation of the OECD was for countries to adopt specific rules which link the tax treatment in one jurisdiction to the tax treatment in another jurisdiction. Examples might be the operation of the Italian participation exemption which requires certification proving that the payment was not deductible in the jurisdiction of the issuer.

Hybrids

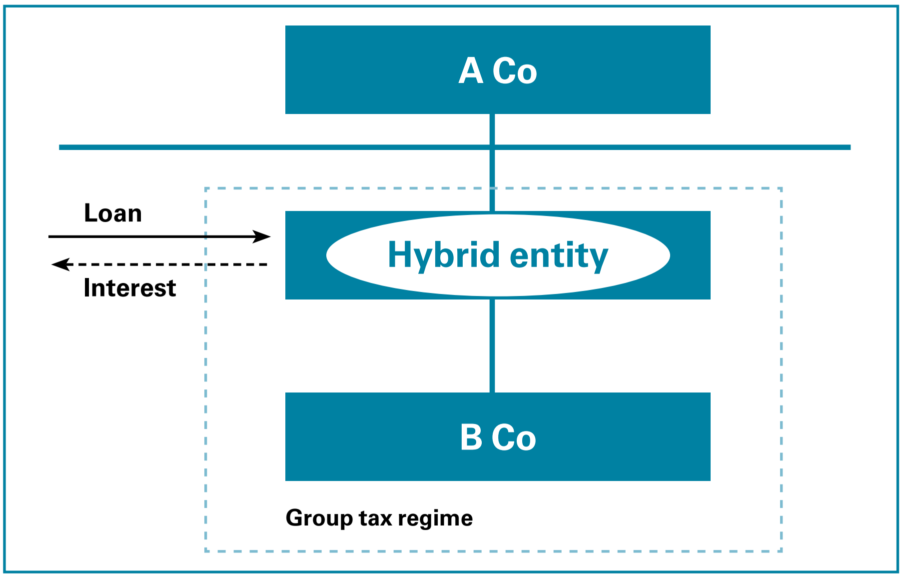
The first is the use of hybrids. In March 2012 the OECD released a report titled *Hybrid Mismatch Arrangements.* It dealt with arrangements that sought to give rise to double deductions for the same contractual obligation or deductions in one country but the exclusion of income in another as well as certain foreign tax credit generators. Such arrangements effectively "arbitrage" different tax rules in different jurisdictions.

Four types of arrangements were identified by the report:

- The use of hybrid entities, which involved entities that are treated as transparent for tax purposes in one country and as non-transparent in another.
- The use of dual resident entities.
- The use of hybrid instruments, most prominently those treated as debt in one jurisdiction and equity in another.
- Hybrid transfers, which involve arrangements that are treated as asset transfers in one jurisdiction but not another.

The main recommendation by the OECD was for countries to adopt specific rules which link the tax treatment in one jurisdiction to the tax treatment in another jurisdiction. Examples might be the operation of the Italian participation exemption which requires certification proving that the payment was not deductible in the jurisdiction of the issuer.

One might expect a rise in the use of such rules globally given that these rules can be enacted in each specific jurisdiction and do not require an international consensus. The proliferation of such rules will not be without their own complexity, given that such rules would need to deal with the imposition of interposed entities and potentially tie-breaker rules to avoid circular reasoning.



Excerpt from OECD, *Hybrids Mismatch Arrangements, 2012 "Double deduction"* with hybrid entity

"The history of transfer pricing is one of increasing complexity. That trend in complexity is likely to continue if the OECD asserts an increasing divergence between the contractual allocation of risk and the real allocation of risk in a multinational group."

Tax avoidance disclosures

Under the March Budget in the UK, companies and individuals who participate in failed tax avoidance schemes will not be awarded Government contracts with a value over EUR5 million. All entities bidding for government contracts above EUR5 million will be required to self-certify that they have fulfilled their obligations in relation to tax compliance. Foreign suppliers will have to certify compliance with overseas rules, where equivalent rules exist.

Transfer pricing and other issues

Historically, transfer pricing has focused on each separate legal entity (or potentially a branch operation that would be treated as a separate legal entity) and the notion of the arm's length price. In more recent times, this focus on price has become a broader question of the appropriateness of the level of profit allocated to a company in a particular jurisdiction.

Current transfer pricing rules, the OECD suggests, are putting too much emphasis on legal structures and contractual conditions rather than the underlying reality of an economically integrated multinational group.

The history of transfer pricing is one of increasing complexity. That trend in complexity is likely to continue if the OECD asserts an increasing divergence between the contractual allocation of risk and the real allocation of risk in a multinational group.

The future of transfer pricing is likely to involve increasing focus on the sometime nebulous concept of the "reallocation of risk".

An alternative direction may involve simplified 'safe harbor rules'. Thus, one could adopt 'cost plus statutory margin' in established circumstances.

Other issues identified in the BEPS paper from the OECD concern the use of finance vehicles in low taxed jurisdictions, where intra-group interest is deductible in high taxed jurisdictions but assessable in low taxed ones.

The OECD also identifies the use of derivatives to minimize withholding taxes and subvert thin capitalization rules which deal with related party debt. Another area of concern involves the use of captive insurance companies. The OECD further highlights the need for effective general anti-avoidance provisions.

Controlled Foreign Corporations (CFC)

Most of the large OECD countries have significant CFC rules.

However, the OECD has suggested that the interaction of hybrid rules with the "check-the-box rules" which involve treating entities as transparent, may deny significant effectiveness to the CFC rules.

For quite complex reasons (based on the interaction of US foreign tax credit limitation rules, interest deductibility and CFC rules), there are a large number of US multinational corporations with considerable non-US cash holdings, (estimated by one academic to be in the order of USD1.4 trillion) that cannot be repatriated to the US without a significant US tax cost. These 'locked-out' funds, have been a focus of debate in the US with some parties advocating a repatriation holiday.

On the other hand, the OECD appears to be focusing on the CFC rules that govern the types of income that should be attributed back to a multinational corporation's home jurisdiction irrespective of whether it is repatriated or not. The future is likely to see a tightening of CFC rules.

Concept of a permanent establishment

The question of whether our long established tax rules embedded in more than 3,000 bilateral treaties world-wide are appropriate in a digital economy has been the subject of significant discussion for at least 15 years, but has reached a crescendo in the last 6 months.

The 1920s involved a major discussion about how to allocate taxing rights. This involved allocating rights between the country where the wealth originated or was sourced and the country where the wealth was spent or residence. From that debate, the concept of 'permanent establishment' arose.

This concept had both a geographical requirement and a temporal requirement. It was thought that in order for the source country to have taxing rights, an enterprise must have a fixed place of business through which the business is carried on in that country. Further, the arrangement must be more than temporary. In addition, it was considered that activities needed to be more than merely preparatory or auxiliary.

On the other hand, it was thought simply by acting through an agent (that was not truly independent) should not provide an avenue for avoiding a permanent establishment.

From these basic principles, there developed a number of exceptions where the source country dominates. These included profits from immovable property, such as mines, profits related to athletes and entertainers, dividends, interest and royalties and, in some more limited cases, technical fees and insurance premiums.

There has been a call to extend such exceptions to the provision of services and goods over the internet on the basis that 'the fixed place of business' rule is no longer appropriate in our digital world.

Recently released data on US CFCs from 2008 US tax returns

		No of US CFCs in country	2008 Year Total receipts of US CFCs	2008 Year Current Profits	2008 Year Profits as a % of country GDP
		No.	USD billions	USD billions	%
	All geographic regions	**83,642**	**6,001**	**662**	
1	United Kingdom	8,707	722	12	1.3
2	Canada	6,829	628	48	2.6
3	Netherlands	3,505	426	94	4.6
4	Switzerland	1,411	324	48	3.5
5	Bermuda	1,008	312	69	645.7
6	Luxembourg	681	271	31	18.2
7	Germany	4,094	263	16	0.2
8	Japan	2,730	261	6	0.3
9	Cayman Islands	1,677	251	43	546.7
10	Ireland	1,202	227	60	7.6
11	Mexico*	4,910	223	18	1.6
12	Spain*	1,785	182	14	0.9
13	France	3,522	170	14	0.3
14	Australia*	2,802	158	24	2.3
15	Singapore	1,843	136	14	3.4
16	China*	4,546	125	9	0.2
17	Brazil*	1,789	123	13	0.8
18	South Korea*	860	99	6	0.6
19	Italy	1,665	82	6	0.2
20	Hong Kong	2,368	71	8	2.8

Source: Content of US Statistics of Income Bulletin 2013 based on 2008 tax return data and Congressional Research Service Calculations combined with IMF GDP data for countries marked*

Press reports indicate that both the US and France have taken a lead in thinking through these issues in the work being undertaken by the OECD. It will be very difficult to gain international consensus on changing the allocation of taxing rights based on source and residence.

Stateless income

The issues that arise under this heading are related to a number of focus areas under consideration by the OECD, but primarily concern corporate tax structures that sit between the ultimate head company and the countries of source or the factors of production.

This is an area of complexity and will commonly involve the interaction of different tax regimes, each with a coherent and sound base.

Some commentators believe that the ultimate solution to this problem is the taxation of a multinational group by dividing up the group profit to various jurisdictions based on sales, inputs on the factors of production or other internationally agreed criteria. This is sometimes referred to as a form of unitary taxation. In the current circumstances, the OECD does not believe that this has political legs on the basis that reaching agreement on a uniform allocation methodology will be too difficult.

This leaves fewer tools to deal with 'stateless income'. Discussion is likely to focus on the appropriateness of check-the-box transparency options, anti-hybrid measures, the interaction with CFC rules and other tax rules as well as transfer pricing when dealing with this area. Acceptable and simple solutions will not be easy.


BUSES
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WHAT TAX ADVISORS DO

Q. Why is so much time spent on tax advice if it is not to put in place schemes to minimize tax, albeit within the law?

A. This is a question being asked by many, including some senior politicians.

For those not familiar with the nature and scope of most corporate tax advice, the question may seem reasonable. Moreover, such views are sustained by grains of truth for some corporate tax advice, particularly if one looks back in time.

Tax is complex. What is not appreciated by many is that this state of affairs is necessarily so given that businesses are complex. All modern tax systems contain deliberate paths whereby things can be done with a smaller tax cost. These paths are explicitly put in place for strong policy reasons. Many argued that, if they were not there, the economy would have a structural inflexibility that may lead to a decline in general welfare.

These policy-based, tax-friendly paths take many forms. We discuss some of the more common ones below.

This is not to deny that some effort has been undertaken by corporate tax advisors to create structures that comply with the letter of the law but now are reference points in the tax morality debate.

However, this should not distort what corporate tax advice is about for the most part.

REORGANIZATION RELIEFS
Virtually all tax systems provide relief from capital gains on certain reorganization. Without such relief, existing business structures would be 'locked in' and there would be significant barriers to acquisition transactions. The delineation between what types of reorganization should be tax-free and what types should not – or to put it another way, wherein lies the tax-free path – is a complex mix of Treasury policy, legal drafting, Revenue interpretation and the practical application of how businesses reorganize. Rarely is that path a simple or a straight one. There are often unexpected and unintended shoals, reefs and bars which need to be considered and navigated. This can be costly and complex. Negotiating such a path is outside the notion of a scheme to minimize tax.

INTEREST WITHHOLDING TAX RELIEF
Most tax systems provide a mechanism for funding without interest withholding tax based on the issue of notes to a wide number of investors. This is a deliberate policy choice to ensure that local businesses can access funding in an internationally competitive manner. Complexity arises from the delineation between the tax-free path of cheaper-funding and the often prohibitive path of a withholding tax. Corporate tax advice addresses that complexity making sure that the rules of the tax-free path are satisfied. This is a positive contribution to competitive funding for local business.

DEBT-EQUITY IS NOT A CLEAR DELINEATION
Other complexity arises because of the need to delineate within a grey spectrum. Debt and equity in their basic forms are like night and day. But drawing a line at dawn and dusk is not easy and sometimes not intuitive. Under Australian tax rules, for instance, a simple loan which is repayable at the call of the lender may be treated as equity or debt depending on whether the turnover of the company is greater or less than AUD20 million, when the loan commenced, the relationship between the borrower and lender and whether any election has been made.

To an outsider this may seem over-the-top complexity, but there are good policy reasons for each of these rules and the corporate tax advisor needs to navigate them to help a business achieve their commercial objectives. Treasury officers and Revenue administrators alike know that the efficient economy requires such navigation. Treasury officers seek out clear channels and Revenue administrators will do their best to post buoys and markers. However, the complexity will always be there and a tax advisor is needed to deal with it.

HOW TO BEST RESPOND

Ultimately this is a changing world – one can resist it or embrace it. The problem with the former is that one tends to get left behind.

1 Watch the developments
Keep abreast of developments which will occur at local country and international forum levels. A good businessman needs to be able to predict the environment not only in the short term, but in the long term. Such developments are the sign-posts to that future.

2 Plan for public discussion
Ensure senior management is aware of the potential risks of a company's tax affairs becoming a public discussion point and for that discussion to be ill-informed. There needs to be a management plan to deal with this. If and when it happens, time will be of the essence.

3 Develop a tax narrative
Develop and be prepared to communicate the narrative underlying your tax numbers. Make sure the story is balanced and supportable and that it deals with a proper time horizon. Use the narrative to inform.

4 Think reputational risk
Ensure that decisions are made taking into account potential reputational risks and not simply whether the tax law in various jurisdictions has been complied with.

What is your approach to enterprise risk management and how does this translate to tax decision?

5 Prepare for discussions with revenue authorities
Ensure that you put in place processes to support discussions with revenue administrators. This is an upfront activity. For example it may involve the appropriate collection of evidence and support for a business purpose in relation to a transaction. It may involve confirmation that the assumptions upon which certain advice is predicated have taken place. The costs of early preparation tend to be significantly smaller than a path of long term conflict and litigation.

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