INTERNATIONAL TAX ISSUES FOR ASEAN

Michael Keen

Jakarta; July 13, 2017

OUTLINE

- Elements of the current framework
- Dealing with avoidance
- Dealing with tax competition too
- Regional coordination?

ELEMENTS OF THE CURRENT FRAMEWORK

Arms length pricing (ALP)—under stress

Allocates profits by valuing intra-MNE transactions at prices unrelated parties would reach

– to avoid distorting organizational form

Critics stress, however:

- Complexity in practice
  - Identifying ‘comparables’ can be hard
- Allocating ‘risk’ is problematic, since borne by MNE as a whole

Source/residence—slippery ideas

System rests on notions of

- Source country
  - But manipulable by avoidance devices
- Residence country
  - But vulnerable to ‘inversion’
  - And why should it matter where a company resides?

DEALING WITH AVOIDANCE

Countries differ

International tax in surveillance

Fund has long advised members on international tax issues in its wider engagement on tax issues

Now systemically highlighting them in surveillance

- Already done for U.S., Peru, Belgium…
- And for Indonesia, Malaysia and the Philippines

Common themes in ASEAN (so far)

- Withholding taxes provide useful protection…

But:

- No thin capitalization rules (M, P)
- Controlled foreign corporation rules needed (I,P)
- Transfer pricing a domestic issue too (M)
- Need for considered policy on treaties (I,P)
- Limited ability to tax indirect transfers (M,P)

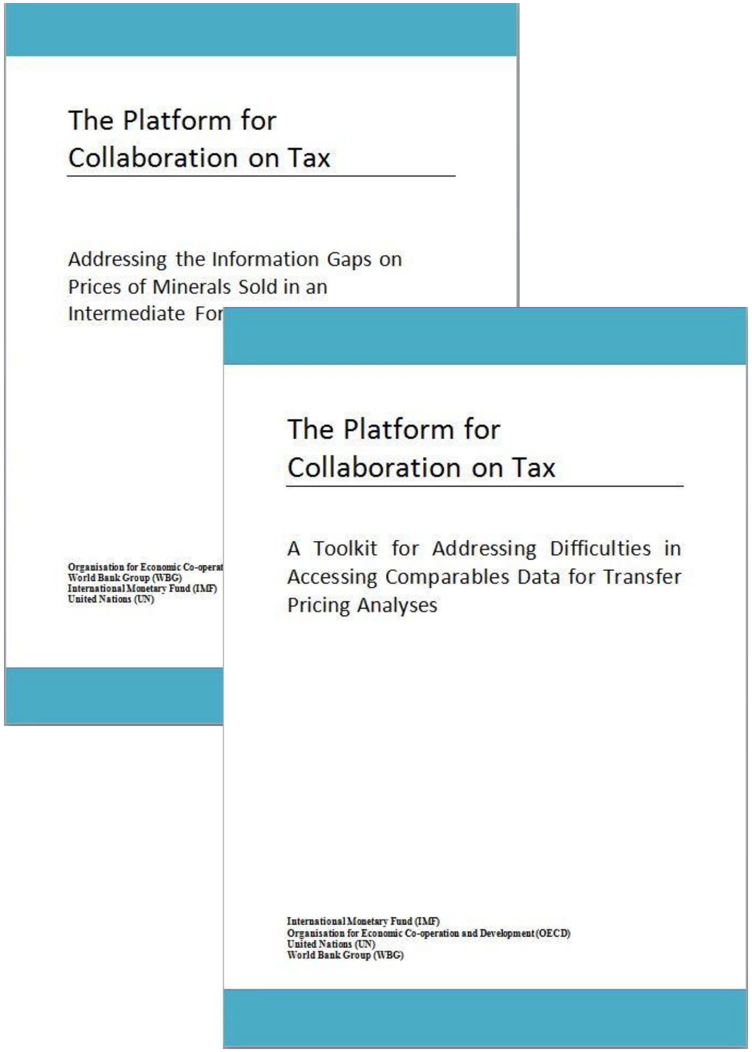
Addressing difficulties in accessing comparables

The Platform Toolkit

Explores:

- Making the most effective use of available information
- Applying ALP in absence of comparables
  —Use of ‘safe harbours,’ other prescriptive measures

Provides material on pricing minerals sold in intermediate form


The Platform for Collaboration on Tax

Addressing the Information Gaps on Prices of Minerals Sold in an Intermediate For

Organisation for Economic Co-operat
World Bank Group (WBG)
International Monetary Fund (IMF)
United Nations (UN)

The Platform for Collaboration on Tax

A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses

International Monetary Fund (IMF)
Organisation for Economic Co-operation and Development (OECD)
United Nations (UN)
World Bank Group (WBG)

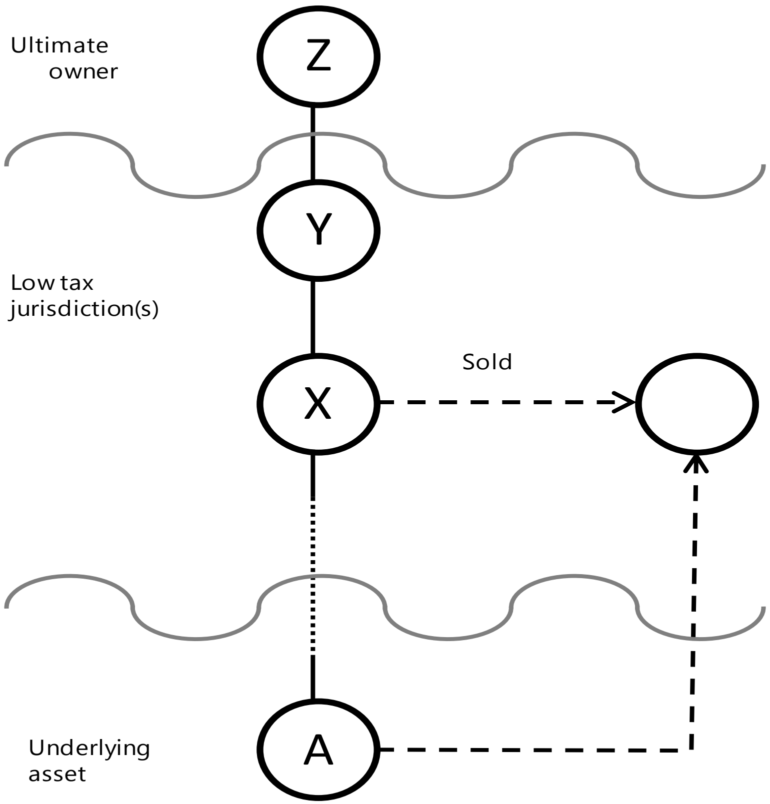
Offshore indirect transfers

Critical for (not only) resource countries

High stakes!

—India *Vodafone*: US$ 2.6 bn; 2 percent of central government revenue

—Uganda *Zain*: US$ 85 mn; 5 percent of total government revenue….



Not addressed in G20-OECD project

The (draft) OIT toolkit

- Guidance on domestic law and treaty policy to ensure source taxation

- Argues for an expansive domestic law definition of ‘immovable assets’
  - To include e.g. government licenses

- Sets out two routes to source country taxation

DEALING WITH TAX COMPETITION TOO— RADICAL OPTIONS

A. (Real) Worldwide taxation

(i.e. without deferral)

Pro: Limits downward tax competition: rate cuts in source country have no effect on investor’s total tax

Cons:

- Vulnerable to inversion
- World moving in opposite direction
  - – Though Brazil, China and India remain worldwide

B. Formula apportionment (1)

- Allocate multinational's total profits across jurisdictions not by ALP but by formula reflecting extent of activities in each
  - E.g. shares of payroll, sales, assets…

  Proposed for EU

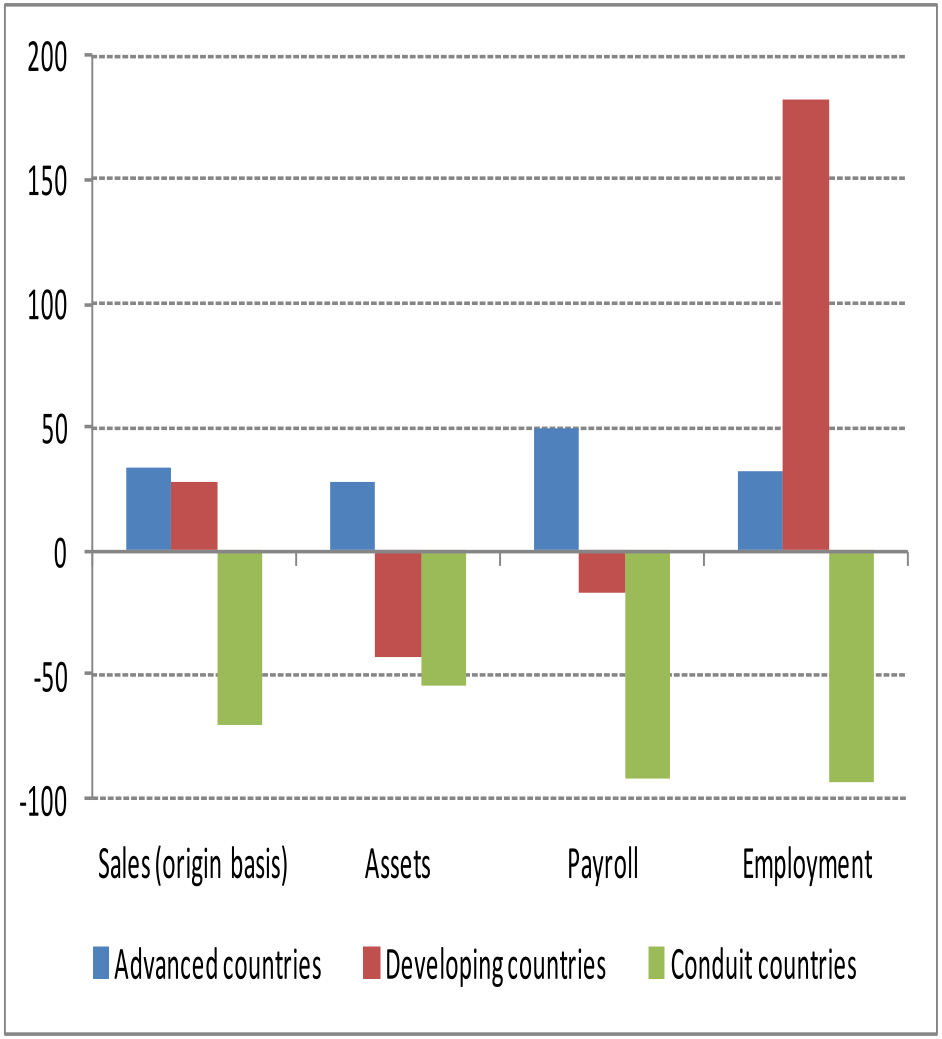
- All subnational CITs have formulaic structure
  - So may be where an integrated world is headed?

Key issues with formula apportionment (2)

Pro: No need to value intra-firm transactions

Cons:

- What formula?
- Whatever it is, can lead to tax competition and game playing



C. Destination-based cash flow tax (DBCFT)

"Cash flow" means:

- Immediate expensing of investment (instead of depreciation)
- No interest deduction

Base of DBCFT is thus 'rents' (= profits in excess of minimum required)

"Destination-based" means:

- 'Border tax adjustment" (BTA) Imports are taxed, exports not taxed

Key features of the DBCFT (2)

- Domestic sales taxed same as imports
- Equivalent to broad-based (subtraction) VAT plus wage subsidy at the same rate
- To get to DBCFT from ‘standard’ corporate tax:
  - Remove tax on normal return
  - Border adjust: move tax base from production to consumption

Things to like about the DBCFT (3)

- Eliminates debt bias
- Does not distort level or location of investment
- Eliminates whole range of avoidance (BEPS) possibilities
  - e.g., Currently, if country A has higher statutory rate than B, set artificially low price for exports from A to B ….but under DBCFT, export price irrelevant in both A (not taxed) and B (not deductible)

Some issues with the DBCFT (4)

- Inconsistency with WTO and, perhaps, tax treaties

    —but not for VAT-based approach

- BEPS problems lightened for adopter, but worsened for non-adopters

- Many design questions

REGIONAL COORDINATION?

Objective

Limiting avoidance and tax competition while preserving some national discretion

– Not harmonization!

Plenty of options—1

- Schemes above can be adopted regionally
  - As European Commission has proposed FA for EU
- Agreement on minimum rates (WAEMU, CEMAC)
  - Can benefit even those obliged to raise rate
  - But need agreement on base too

Plenty of options—2

- Code of conduct precluding some kinds of incentive —soft law
- State Aid rules—tough law
- Common treaty policy
- Pre-budget consultations (EAC)

Making progress

- Not easy
  - ‘Free-rider’ problem: non-joiners likely benefit most

But EU experience shows:

- This is <u>the</u> core tax issue in regional integration
- It gets harder to address as integration deepens