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Durst is also the author of the forthcoming book *Taxing Multinational Business in Lower-Income Countries: A Problem of Economics, Politics and Ethical Norms*, which *Tax Notes International* is serializing in six installments. The book explores a topic that has been highly controversial in recent years: the use by multinational companies of "base erosion and profit-shifting" tax planning structures to reduce their tax liabilities in countries where they conduct business, including the world's lower-income developing countries. In this installment, which is Chapter 5, the author considers five kinds of policy instruments that might offer significant protections against base erosion for lower-income countries. The most recent installment appeared in *Tax Notes Int'l*, June 4, 2018, p. 1157.

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Introduction

In the preceding four chapters of this book, I have sought to explore (i) the economic and political roots of base erosion and profit shifting in lower-income countries and (ii) the recent (and continuing) efforts of the OECD and other international organizations to redress the problem, in connection with the BEPS studies. Based on the analyses in these prior chapters, I offer in this chapter suggestions for policy initiatives that seem especially promising for lower-income countries. These include some measures recommended by the BEPS studies and others that are outside their scope.

In particular, this chapter explores the following options:

(1) incremental improvements to transfer pricing administration, including modifications to current practices for selecting "comparables," the possible use of transfer pricing safe harbors, and "capacity building" to increase audit coverage of multinational companies;

(2) limitations on interest deductions;

(3) modifications to countries' tax treaty policies to prevent "treaty-shopping";

(4) a policy instrument that the BEPS reports do not address but which already is used by some developing countries around the world, alternative corporate minimum taxes based on taxpayers' gross revenues (turnover); and

(5) for hard-to-tax industries, greater use of tax instruments based on gross revenue rather than net income, like carefully structured royalties in the area of natural-resource taxation, and excise taxes in industries like telecommunications and electronic commerce.

Improvements to Transfer Pricing Methods and Practices

Simplifications Relating to Searches for Comparables

In 2016, after the publication of the BEPS reports, the Platform for Collaboration on Tax (PCT), which is a joint undertaking of the OECD, the World Bank, the IMF, and the United Nations,[1] published a "Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses."[2] The Toolkit responds to complaints by tax administrators that the standards for selecting comparables under the OECD's transfer pricing methods are unrealistically restrictive, preventing tax inspectors from persuasively supporting arguments that locally operating companies are not earning sufficient levels of income under the arm's-length standard.[3] The Toolkit discusses various ways in which tax administrations might modify their practices with respect to the selection and analysis of comparables to improve their revenue recoveries from transfer pricing examinations.

Based on my experience as a practitioner, I am confident the Toolkit is correct in identifying difficulties in locating usable comparables as a central and pervasive problem in transfer pricing enforcement. In practice, as I described in Chapter 3, the problem often arises under a particular transfer pricing method that the OECD incorporated in its Guidelines in 1995, the Transactional Net Margin Method (TNMM). This is the transfer pricing method that tax administrations in lower-income countries often use in trying to test whether members of multinational groups operating in their jurisdictions are earning reasonable, arm's-length levels of income, as opposed to shifting income excessively in BEPS-style planning structures.

As described in Chapter 3, the drafters of the OECD Transfer Pricing Guidelines were concerned that tax inspectors might apply the TNMM against inbound investors in an automatic fashion, essentially requiring minimum levels of taxable income with insufficient regard to the facts and circumstances of the taxpayer under examination. In an effort to prevent this, the drafters included language requiring that tax administrations apply the TNMM only after an exhaustive factual study of the taxpayer under examination (often called a "functional analysis"), and the identification of comparable companies that are closely similar to the taxpayer.[4]

These requirements have raised two serious problems for tax auditors. First, the level of detailed factual analysis that the Guidelines require is beyond the budgetary and personnel capacity of even well-resourced revenue agencies, and in practice tax examiners typically must conduct analyses that are far more perfunctory

[1] See generally OECD, "Platform for Collaboration on Tax" (2016).

[2] Platform for Collaboration on Tax, "A Toolkit for Addressing Difficulties in Accessing Comparables Data for Transfer Pricing Analyses" (2017).

[3] The PCT summaries the tax administrations' concerns in the following language:

> Available statistics and academic research on the availability of information on comparables corroborate the difficulties reported by many developing countries. Often, the information relevant to a jurisdiction can only be accessed through the purchase of a license from database providers. However, even putting aside the financial cost of acquiring access to such databases, challenges for developing country tax administrations often remain, particularly in cases where little relevant information relating to a specific jurisdiction or even region exists. Where the information does exist, it may exhibit differences compared to the transactions under review. Typically, in such cases, transfer pricing practitioners need to consider using imperfect data, including the use of data from foreign markets. However, the effectiveness of such approaches has not been studied sufficiently to enable definitive conclusions to be drawn about when they are reliable or how any adjustments to account for such differences should be applied.
>
> A common concern of developing economies in the implementation of transfer pricing regimes relates to difficulties in accessing information on "comparables": data on transactions between independent parties used in the application of the arm's length principle. In response to this challenge and under a mandate from the Development Working Group of the G20, the Platform for Collaboration on Tax (PCT) — a joint initiative of the IMF, OECD, UN, and World Bank Group — has developed a toolkit to assist tax administrations of developing countries.

Id., at 12.

[4] A flavor of the level of detailed inquiry that the Guidelines require of tax administrations is provided by paragraphs 1.34 and 1.35 of the current (2017) version:

> 1.34 The typical process of identifying the commercial or financial relations between the associated enterprises and the conditions and economically relevant circumstances attaching to those relations requires a broad-based understanding of the industry sector in which the MNE group operates (e.g. mining, pharmaceutical, luxury goods) and of the factors affecting the performance of any business operating in that sector. The understanding is derived from an overview of the particular MNE group which outlines how the MNE group responds to the factors affecting performance in the sector, including its business strategies, markets, products, its supply chain, and the key functions performed, material assets used, and important risks assumed. This information is likely to be included as part of the master file as described in Chapter V in support of a taxpayer' analysis of its transfer pricing, and provides useful context in which the commercial or financial relations between members of the MNE group can be considered.

(Footnote continued on next page.)

than the Guidelines purport to require. Second, the standard of similarity that the OECD Guidelines require, for the selection of comparables, is unrealistically demanding. Even after extensive combing through available financial databases, examiners typically can identify only a very few companies (in my experience, typically less than 10) that are plausibly comparable to the taxpayer under examination, and even that number often requires stretching the notion of functional comparability beyond what the Guidelines seem to envision. The resulting sample of, say, five to ten approximate comparables is much fewer than necessary, under standards of reasonable statistical practice, to offer a persuasive indication of the "true" arm's-length level of income of the taxpayer under examination.[5]

At best, the kinds of comparables examinations performed in practice can pin the taxpayer's "arm's length" profit level within a very wide range, for example, between a net operating margin of 2 and 8 percent. This would mean that for a taxpayer with $100 million of sales, the arm's length range of income might be found anywhere between $2 million and $8 million. Arm's length ranges this broad are of limited use to tax administrations in seeking to enforce reasonable levels of taxable income for locally operating subsidiaries of multinational groups. Accordingly, TNMM has not served as an effective enforcement tool even in relatively wealthy countries, and the problems appear to be especially serious in developing countries.

The Toolkit recommends several ways tax administrations might improve the performance of TNMM by expanding the pool of acceptable comparables. For example, tax administrations might accept comparables located in countries other than their own, making adjustments for differences in prevailing economic conditions;[6] or they might accept comparables with less functional similarity to the taxpayer under examination than has been required in the past.[7] The Toolkit even includes, as a possibility to be evaluated, the adoption of transfer pricing regimes similar to Brazil's, under which margins to be used for transfer pricing enforcement are not generated through case-by-case searches for comparables, but are instead prescribed by fiat by the tax administration.[8]

These suggestions of the Toolkit are intriguing; and I have little doubt that adding flexibility to the identification of comparables could improve the performance of TNMM as a tax enforcement tool. Broadening the definition of comparability, however, would challenge the implicit political settlement from 1995, that tax inspectors should have the capability to make tax adjustments under TNMM only in cases of exceptional noncompliance. Even if one or more lower-income country governments were willing politically to adopt a standard of comparability that is more permissive than that applied generally around the world today, taxpayers might resist the new approach vigorously in tax audits, arguing with some justification that the new permissiveness departs from the arm's-length principle as envisioned by the drafters of the 1995 Guidelines. Tax inspectors' determinations might be overturned in appellate or judicial proceedings; or government officials might feel compelled to intervene in favor of taxpayers, especially those that play large and visible roles in the local economy.

This is not to say that research aimed at widening the pool of comparables under TNMM

1.35 The process then narrows to identify how each MNE within that MNE group operates, and provides an analysis of what each MNE does (e.g. a production company, a sales company) and identifies its commercial or financial relations with associated enterprises as expressed in transactions between them. The accurate delineation of the actual transaction or transactions between the associated enterprises requires analysis of the economically relevant characteristics of the transaction. These economically relevant characteristics consist of the conditions of the transaction and the economically relevant circumstances in which the transaction takes place. The application of the arm's length principle depends on determining the conditions that independent parties would have agreed in comparable transactions in comparable circumstances. Before making comparisons with uncontrolled transactions, it is therefore vital to identify the economically relevant characteristics of the commercial or financial relations as expressed in the controlled transaction.

Detailed instructions for implementing these principles occupy many additional paragraphs of the Guidelines.

[5] See generally Michael C. Durst and Robert E. Culbertson, "Clearing Away the Sand: Retrospective Methods and Prospective Documentation in Transfer Pricing Today," 57 *Tax Law Review* 37, 108-114 (2003).

The PCT Toolkit, note 2 above, cautions (at pp. 61 and 140) that large sample sizes are necessary for proper application of statistical techniques in determining arm's-length ranges.

[6] PCT Toolkit, note 2 above, at 57-60.

[7] *Id.* at 47-48.

[8] *Id.* at 75-76.

is not desirable. The potential revenue benefits from successfully easing the barriers to large-scale and effective application of TNMM could be considerable. Nevertheless, the effort should be pursued with recognition of the political resistance, both explicit and tacit, that it is likely to encounter.

Transfer Pricing Safe Harbors

The PCT recommends that developing-country governments consider adopting transfer pricing safe harbors as part of their efforts to improve the performance of TNMM.[9] Under a program of safe harbors, the tax authority prescribes minimum operating margins for different kinds of businesses (for example, distributors, manufacturers, and providers of various kinds of services, like the operation of call centers or the performance of research and development). Taxpayers that report incomes of at least the safe harbor level are protected from transfer pricing examination (except to the extent needed to verify the taxpayer's compliance with the safe harbor).[10] The hope is that taxpayers will find it worthwhile to comply with the safe harbors, rather than taking more taxpayer-favorable positions on their returns and facing the costs and inconvenience of a detailed audit, as well as the risk of a tax adjustment and possible penalties.

A safe harbor regime requires compromise on the part of both the taxpayer and the tax administration. The taxpayer voluntarily reports a relatively high level of income (perhaps higher than the taxpayer believes is necessary under the arm's-length standard); and the government specifies required safe harbor levels somewhat lower than it might seek to insist upon in the course of a tax audit. Through this compromise, both the taxpayer and the government are relieved of the costs and uncertainty of transfer pricing audits.

I believe safe harbors can provide benefits in countries of all levels of economic development, especially in developing countries where tax administration resources tend to be very constrained.[11] For this reason, I welcomed the OECD's decision in 2012 to end its prior opposition to the use of safe harbors. To date, however, transfer pricing safe harbors have not fulfilled the promise that I and others perceive in them. The only country of which I'm aware to have implemented a comprehensive system of safe-harbor margins under TNMM has been India, in 2013.[12] Few taxpayers, however, took advantage of the Indian safe harbor, apparently because taxpayers perceived the safe-harbor margins as unrealistically high. In June 2017, India issued revised safe harbor rules with lower margins, but it is too soon to know whether taxpayer use of the system will increase.

As the Indian experience demonstrates, a barrier to the success of safe harbors is the tendency of taxpayers who challenge government positions in transfer pricing audits to achieve very favorable resolutions. Statistics on transfer pricing audits in the United States illustrate this phenomenon. In 1995, a U.S. congressional report determined that on average, less than 20 percent of amounts that examiners proposed as adjustments in transfer pricing audits were upheld following administrative appeals (and litigation if needed).[13] During the subsequent two decades, although the U.S. tax administration devoted substantial resources to improving transfer pricing administration, the situation did not change. A report by the U.S. Treasury's Inspector General, in 2016, reported that the 20 percent sustention ratio had remained virtually

[9] Transfer pricing safe harbors are described generally in Chapter 4 of this book. The PCT Toolkit, note 2 above, discusses safe harbors at pp. 69-73.

[10] For example, a country's tax administration might provide that so long as a local distributor of consumer goods, on behalf of a multinational group, earns a net operating margin of at least "x percent," the distributor will be immune from transfer pricing examination other than as might be necessary to verify compliance with the safe harbor.

[11] See, for example, Durst and Culbertson, note 5 above, at 124-127, 132-133; Michael C. Durst, "Pragmatic Transfer Pricing for Developing Countries," *Tax Notes Int'l*, Jan. 23, 2012, p. 279.

[12] See generally news analysis of KPMG India, "CBDT notifies the much awaited revised Safe Harbour Rules" (June 9, 2017). See generally the discussion of experience to date with safe harbors in Richard S. Collier and Joseph L. Andrus, *Transfer Pricing and the Arm's Length Principle After BEPS* (2017) at 269-270; and Patricia G. Lewis, "Where Have All the Safe Harbors Gone? A Plea for Reinvigoration," Bloomberg BNA Transfer Pricing Report (Feb. 23, 2017). It should be mentioned in addition that Mexico has in place a safe harbor regime for transfer pricing with respect to maquiladoras, which are regulated manufacturing subsidiaries of multinational groups. See United Nations Practical Manual on Transfer Pricing (2017), at section D.4.9.

[13] U.S. General Accounting Office, "Transfer Pricing and Information on Nonpayment of Tax" (Apr. 1995).

constant.[14] There is little reason to believe that the situation with respect to transfer pricing examinations is more satisfactory outside the United States. All countries that subscribe to the OECD Guidelines are beholden to the same indeterminate transfer pricing methods, which lead tax examiners to propose adjustments that cannot be sustained.

This situation poses a substantial challenge to the successful design and implementation of safe harbors. The root of the problem is that there tends to be a wide gap between the levels of income that tax auditors and taxpayers believe to be "arm's length." Safe-harbor income levels prescribed by tax administrations therefore may be too high to attract much taxpayer participation. For transfer pricing safe harbors to be effective, tax administrations will need to be willing to prescribe safe-harbor income levels closer to the levels on which taxpayers can realistically expect to prevail in an audit.

This doesn't mean that the safe-harbor income levels need to be fully as low as those on which taxpayers tend to prevail on audit. Taxpayers likely will agree to abide by safe-harbor levels that are somewhat higher than the results that they believe likely to be sustainable on audit, as a reasonable trade-off for avoiding the costs and uncertainties of the examination process. Successful safe harbors, however, will need to incorporate prescribed income levels that are reasonably close to taxpayer expectations of what constitutes a fair arm's-length result. To date, no country appears to have succeeded in designing a safe harbor regime with margins high enough to satisfy the expectations of the tax administration, but low enough to invite widespread taxpayer participation. For safe harbor regimes to succeed, this gap will need to be narrowed.

At least in theory, it should be possible to identify safe-harbor margin levels that viably balance the expectations of taxpayers and tax administrations. Safe-harbor margins set at this kind of optimal level should generate additional tax revenues while at the same time conserving tax-administration resources, and according enhanced certainty of result to all participants in the system. Experience to date suggests, however, that progress toward these kinds of balanced safe harbors may be both difficult and slow. Given the potential benefits of safe-harbor regimes, especially in developing countries, efforts to develop workable safe harbors should continue. Policymakers should recognize, however, that safe harbors are unlikely to provide a comprehensive solution to the difficulties of transfer pricing administration, at least for the foreseeable future.

Capacity Building in Transfer Pricing Administration

For years, international organizations have offered instruction and other technical assistance to developing-country tax administrations to increase the skill levels of tax inspectors in applying OECD transfer pricing methods.[15] It is important, I believe, to recognize the limitations of capacity building, in and of itself, as a means of improving the performance of transfer pricing administration. Even tax administrations with a high level of training experience difficulties in applying the available transfer pricing methods: Problems relating to the identification of comparables, and the need to perform extensive factual examinations, affect even the most highly trained transfer pricing examiners. There is even a danger that an excessive focus on capacity building may divert attention and resources from needed substantive improvements to current transfer pricing rules.

Despite these concerns, however, I believe that capacity building, even under current transfer pricing rules, in many cases can be cost-effective. This is especially likely to be true to the extent the capacity building leads to more extensive audit coverage of large taxpayers. Owing to the vagaries of existing transfer pricing methods, the amounts recovered in examinations may be substantially lower than the original assessments sought by the examiners. Nevertheless, the amounts recovered can be significant, and in the

[14] U.S. Treasury Inspector General for Tax Administration, "Barriers Exist to Properly Evaluating Transfer Pricing Issues" (Sept. 28, 2016).

[15] For an overview of technical assistance efforts by international organizations, including capacity-building in transfer pricing administration, see Platform for Collaboration on Tax, "Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries" (July 2016).

aggregate the revenues raised from expanded audit coverage could be substantial.

Tax Inspectors Without Borders (TIWB), a joint initiative of the OECD and the United Nations, has reported significant revenue recoveries from some of their capacity-building efforts to date.[16] These reports are somewhat anecdotal; it would be useful for TIWB to provide more details of the particular kinds of audits, and audit techniques, that have generated the increased revenues. Nevertheless, it is reasonable to expect that if capacity-building efforts generate higher audit coverage, especially of relatively large taxpayers, additional revenues are likely to result. Accordingly, high-quality capacity-building efforts — that is, efforts which lead directly to higher audit coverage — are likely to be cost-effective for the foreseeable future, even if the transfer pricing methods available to tax administration personnel remain flawed.

The Platform for Collaboration on Tax warns of an important possible impediment to successful capacity-building: fear of alienating investors can limit the willingness of host governments to support capacity-building efforts.[17] The PCT observes, "An indispensable prerequisite to improving tax capacity is enthusiastic country commitment."[18] Even overt conflict between those providing technical assistance, and the governments they are supposed to be assisting, is not unknown.[19] It is inevitable that political aversion to expanded tax enforcement will in some and perhaps many circumstances pose challenges to successful capacity building. The potential benefits of capacity building, however, especially when those efforts lead to enhanced audit coverage, suggest that in many cases, efforts should be cost-effective despite the possibility of some political ambivalence on the part of host-country governments.

Limitations on Interest Deductions

Chapter 4 described the OECD's BEPS recommendation that countries adopt limitations on companies' deductions for their net interest expenses, generally limiting deductions to no more than 30 percent of a company's earnings before interest, taxes, depreciation, and amortization, or EBITDA. This recommendation is based on rules that first Germany (in 2007), and later some additional countries, had implemented to protect their tax bases even before the OECD's BEPS process had begun.

It is essential that a country's base-protection measures include limitations on interest expenses in addition to transfer pricing rules. Transfer pricing rules under the OECD Guidelines generally seek to place a floor, at an arm's-length level, on a taxpayer's "operating income."[20] Operating income is defined as all of a company's revenue, minus the cost of goods sold and all other expenses (like salaries and administrative expenses) *except interest expense.* That is, by accounting convention, a company's interest expenses generally are not considered "operating expenses." OECD transfer pricing methods, therefore, generally do not prevent companies from reducing their incomes to low levels by paying interest on loans from related parties. In addition to transfer pricing rules, countries need to enact specific limitations on interest deductions to avoid leaving a large gap in their protections against BEPS-style tax avoidance.

An EBITDA-based limitation along the lines recommended by the OECD generally represents a balanced approach to the problem of interest deductions. The data analyzed by the OECD[21] suggest that for most companies, a 30 percent of EBITDA limitation should be in excess of the

[16] OECD, "Tax Inspectors Without Borders: Frequently Asked Questions."

[17] See generally Platform for Collaboration on Tax, "Enhancing the Effectiveness of External Support in Building Tax Capacity in Developing Countries" (June 2016).

[18] *Id.* at 3.

[19] The PCT acknowledges the presence of this conflict in some instances, and reports mixed results in addressing it:

> In one country, the Ministry of Finance and the Revenue Agency could not agree on the implementation plan for a WBG project, leading to its failure. In another, the Tax Department refused even to meet with the IMF/WBG team that was diagnosing the situation. Ultimately, in a show of real commitment, the Prime Minister established an entirely new revenue agency—with a much smaller staff and fewer decentralized offices—which had been identified as a locus of much corruption. The ministry and new agency worked enthusiastically together to implement the CD project, contributing fundamentally to its success.

Id. at 18.

[20] See, for example, OECD Transfer Pricing Guidelines (2017), para. 2.68.

[21] See OECD, Report on BEPS Action 4 (2015), at 87-89.

interest deductions needed for *bona fide* business purposes. Nevertheless, the data indicate that many companies have been deducting interest substantially in excess of the 30 percent level, so a limitation at that level should result in revenue gains.[22] Administratively, an EBITDA-based limit on interest deductions is relatively simple; while some complicated questions are raised (for example, whether certain payments that are not labeled as interest nevertheless are "the economic equivalent of interest"[23]), precedents for handling these questions already exist in a number of countries. Thus, implementation of the rules recommended by the OECD generally should be feasible for developing countries, especially with technical assistance from countries experienced with implementation of similar provisions.

To date, however, lower-income countries appear to have been reluctant to adopt EBITDA-based interest limitations as recommended by the OECD. To some extent this undoubtedly reflects lower-income countries' generally heightened sense of vulnerability to tax competition. In this connection, in many lower-income countries, a few large multinationals can account for relatively large proportions of the total corporate tax base. If one or more of these companies is currently deducting large amounts of interest in connection with BEPS-style tax planning, a legislative proposal to tighten limitations on interest expense becomes in effect a negotiation with these taxpayers, which may possess substantial political leverage.

Despite the apparent political constraints, EBITDA-based limits on interest deductions offer significant revenue potential for lower-income countries, and adopting these kinds of limits should be seen as an important policy goal, even if progress toward that goal may be gradual and uneven across countries. Technical assistance in estimating the potential revenue gains, using data from filed corporate tax returns, might be especially helpful to lower-income countries. Technical assistance of this kind could provide benefits even outside the field of interest limitations, as it could provide an occasion for diagnosing needs for better collection and maintenance of tax return data, which is necessary not only to evaluate potential policy initiatives but also to monitor revenue-agency performance.

Efforts to Reduce Treaty Shopping

As described in Chapter 4, countries at all levels of economic development have entered into a network of thousands of bilateral income tax treaties. As discussed in Chapter 4, among the many provisions typically contained in tax treaties are agreements by the parties to reduce, sometimes to zero, the withholding taxes that countries impose on outbound payments of dividends, interest, royalties, and sometimes service fees. As discussed in Chapter 4, (i) the reduction or elimination of withholding taxes under treaties is inappropriate with respect to cross-border payments made in connection with BEPS-style tax avoidance plans, and (ii) the problem of inappropriate reductions or exemptions of withholding taxes is greatly exacerbated by the problem of "treaty shopping."

As described in Chapter 4, treaty shopping involves the use of zero- or low-tax countries as conduits in triangular corporate arrangements. For example, under a typical loan-centered tax avoidance plan, a multinational based in Country A might establish a finance subsidiary in Country L, a zero- or low-tax jurisdiction. The finance company lends funds to another group member in Country B, a lower-income country. Countries B and L have entered into a tax treaty under which withholding tax on cross-border interest payments is reduced to zero. When the group member in Country B pays interest to the finance company in Country L, the multinational group as a whole enjoys a tax benefit, because the interest is deductible in Country B but there is no tax obligation on receipt of the interest in Country L. A withholding tax, on the payment of the income from Country B, would discourage this kind of tax avoidance, but the withholding tax is eliminated under the tax treaty between Countries B and L. It often is argued that the use of the treaty in this situation is improper: The treaty that provides exemption from withholding taxes is between countries B and L, but the

[22]Preliminary results from adoption of a 30 percent limitation by Finland support the expectation of revenue gains. See Jarkko Harju, Ilpo Kauppinen, and Olli Ropponen, "Firm Response to an Interest Barrier: Empirical Evidence," Working Paper 90, VATT Institute for Economic Research (2017).

[23]See OECD Report on BEPS Action 4, at 29-31.

ultimate beneficiary of the exemption from withholding tax is the parent of the multinational group, in Country A. In practice, a large number of BEPS-style tax planning structures around the world rely on treaty shopping of this kind.[24]

The OECD, in its BEPS recommendations, has recommended that countries include in their treaties provisions designed to deny benefits of the treaties, like exemptions from withholding taxes, when corporate groups use the treaties under conduit arrangements. As discussed in Chapter 4, however, the OECD's recommended standards for identifying improper conduit arrangements are subjective and probably will be difficult for tax administrations to enforce. Therefore, even if a large number of lower-income countries adopt the OECD anti-treaty-shopping recommendations (and they may feel constrained from doing so by pressures of tax competition), the resulting reduction in profit shifting may be relatively small.

In theory, lower-income countries could gain protection from treaty shopping simply by refraining from entering into tax treaties with countries that serve as conduits, and even terminating existing treaties to which they are already party. Indeed, in a few recent instances, countries have withdrawn from treaties that appeared to be used to facilitate excessive tax reduction.[25] It is tempting to envision a coordinated refusal of lower-income countries to maintain tax treaties with countries that allow the treaties to be used in BEPS-style planning arrangements.

There are two substantial barriers, however, one political and the other technical, to a "just say no" policy for lower-income countries against maintaining tax treaties with zero-tax or low-tax jurisdictions. Politically, the treaties to which lower-income countries already are party may have been negotiated at the behest of particular investors. In general, the pressures of tax competition that induced low-income countries to agree to these treaties are unlikely to have disappeared; and in many situations countries may not be able to garner the political will to terminate the treaties.

From a technical standpoint, refraining from entering into tax treaties would leave lower-income countries with an acute dilemma in the design of withholding tax rules, which it would be difficult to solve effectively. The basic problem is that withholding taxes are sensible for lower-income countries, from a policy standpoint, in some circumstances but not in others. When deductible payments are made from a country in connection with BEPS-style tax avoidance plans, the withholding taxes compensate for tax revenues that the country is losing through artificially contrived deductions. When taxpayers are *not* engaged in BEPS-style planning, however, the deductions they take for outbound payments of interest, royalties, and service fees may well represent legitimate costs of doing business, and to deny the benefits of these deductions could result in excessive levels of taxation.

In theory, a lower-income country might solve this problem by enacting legislation that imposes withholding taxes only on payments being made to recipients in zero- or low-tax countries. Legislation of this kind, however, likely would encounter the same kind of political resistance from investors that would attend countries' attempts to terminate existing treaties. In addition, drafting the legislation would involve politically difficult definitional issues, including notably the definition of the zero- or low-tax countries to which the rule is to apply.

Further, even if legislation imposing withholding taxes only on payments to designated zero- and low-tax countries could be enacted, enforcement of the law would confront difficult practical challenges. Among the most serious would be the possibility of "back-to-back" conduit arrangements by members of corporate groups. By a virtually unlimited variety of possible conduit arrangements, taxpayers can channel, through normally high-tax countries, payments that ultimately are destined for companies in zero-tax or low-tax jurisdictions. For example, a loan might be made from a group

[24] For an empirical study, see Francis Weyzig, "Tax Treaty Shopping: Structural Determinants of Foreign Direct Investment Routed through the Netherlands" (2012).

[25] For a discussion of circumstances in which developing countries have sought renegotiation of, or have revoked, existing income tax treaties, see Martin Hearson, "Tax Treaties in Sub-Saharan Africa: A Critical Review," Working Paper, LSE Research Online (2015), at 26-28.

member in Country L, a zero- or low-tax country, to another group member in Country A, which imposes a corporate income tax at normal rates. The company in Country A might then on-lend the amount of the loan to a group member operating in Country B, another country with normal tax rates. Interest paid from Country B would theoretically be taxable in Country A, but the interest would be deducted when paid from Country A to Country H, thus zeroing out the group's Country A tax liability.[26] The net result is the same as if the group member in Country B had borrowed money directly from Country L. It would be difficult if not impossible for lower-income countries to track payments made from their jurisdictions to determine whether the payments ultimately are bound for zero- or low-tax countries under back-to-back arrangements.

Overall, therefore, the difficult problem of avoidance of withholding taxes through treaty shopping remains largely unsolved by the BEPS project. As discussed in Chapter 4, the OECD's new multilateral instrument (MLI) offers some potential benefits, but it is unlikely to represent anything approaching a full solution to the problem of treaty shopping in lower-income countries.[27] Moreover, countries appear not to have available unilateral legislative solutions that are likely to be both politically and technically viable.

All things considered, the best policy posture available for lower-income countries probably is to (i) participate in the OECD's MLI project, but to do so with caution, recognizing that at best the project can provide only partial protections against treaty-shopping; (ii) consider terminating particular treaties that appear to be facilitating large volumes of tax avoidance (although there is likely to be political resistance to any movements toward termination); and (iii) avoid entering into new treaties unless iron-clad protections are included against treaty shopping. Even countries that take all these steps, however, are likely to experience continuing difficulties in attempting to control BEPS through the use of withholding taxes.

The Alternative Corporate Minimum Tax

Structure and Basic Appeal of an ACMT

Some developing countries currently employ alternative corporate minimum taxes (ACMTs) based on a company's turnover, and these can afford countries some degree of control over tax-base erosion. In basic structure a turnover-based ACMT is relatively simple. Assume for example that a country imposes its regular corporate income tax at a rate of 30 percent, and backs up the regular tax with an alternative corporate minimum tax of 1 percent of turnover. Assume further that a particular taxpayer has turnover during a taxable year of $10 million, but because of high deductions for interest, royalties, and service fees paid to related parties in zero- or low-tax countries, the taxpayer's net taxable income is only $200,000. The taxpayer therefore faces a regular corporate income tax liability of 30 percent of $200,000, or $60,000. The taxpayer's alternative minimum tax liability, however, is 1 percent of $10 million, or $100,000. Because the ACMT liability is larger than the regular tax amount, the ACMT liability becomes the taxpayer's corporate tax obligation for the year.

The primary appeal of a turnover-based ACMT is ease of enforcement. A taxpayer's liability under a turnover-based tax is unaffected by the kinds of tax deductions for interest, royalties, and service fees that fuel BEPS planning structures. The tax administration therefore does not need to struggle with the limitations of existing transfer pricing methods in attempting to control these deductions.

Further, in addition to being unaffected by a taxpayer's deductions, a turnover-based ACMT is much less vulnerable than the regular income tax to another important kind of BEPS-style tax avoidance, which, as described in Chapter 2, typically involves the below-market pricing of natural resource and agricultural products sold to related purchasing companies by corporate

[26] See, for example, "Canada's 2016-17 Federal Budget Affects Back-to-Back Arrangements," Deloitte World Tax Advisor (Apr. 8, 2016); and Michael N. Kandev, "Canada Extends Back-to-Back Regime: Examining the Character Substitution Rules," *Tax Notes Int'l*, June 19, 2017, p. 1087.

[27] In particular, as discussed in Chapter 4, the MLI affords countries the option to elect anti-treaty-shopping provisions based on a difficult-to-enforce "principal purpose" test; moreover, lower-income countries may encounter political difficulty in applying the MLI to some or all of their existing tax treaties.

subsidiaries operating within a country.[28] The turnover-based ACMT therefore serves effectively as a backstop against BEPS-style tax avoidance of all kinds, not only avoidance through the overstatement of deductions.

Alternative corporate minimum taxes are already fairly widespread among developing countries. A 2015 article reports use of an ACMT, in some form, by 36 countries, although these include countries that base their minimum taxes on a company's assets rather than its turnover.[29] (Basing an ACMT on assets rather than turnover arguably causes the tax to correlate better with a taxpayer's net income,[30] but a turnover-based tax should be much easier to administer.) Based on review of national tax summaries in EY's Worldwide Corporate Tax Guide,[31] I have identified 20 countries that impose an ACMT that is based either entirely or partially on turnover.[32]

The details of the taxes vary substantially, however, from country to country. For example, as reported in the EY Guide, some countries in this group exempt certain taxpayers, like startup companies, from the ACMT; and in a few countries the amount of the minimum tax is capped at what appears to be a very low level.[33]

Although, as will be discussed below, the ACMT is worthy of much more research than has been conducted to date, the limited information that is publicly available suggests that where the tax is applied, it is likely to account for an important component of corporate tax revenue. An analysis published in 2015, of a 0.5 percent turnover-based ACMT in Pakistan, found that over half of firms were liable for the tax, and that it accounted for more than half of corporate tax receipts.[34] A 2016 study of the tax system in Mali, by the IMF, reports that the country's 1 percent, turnover-based ACMT was paid by 36 percent of corporate taxpayers in 2013 and accounted for 11.8 percent of corporate tax revenue.[35]

The relatively high revenue yield of a turnover-based ACMT, and the high percentage of taxpayers affected by the tax, are not surprising. Even at a rate of 1 percent, an ACMT based on turnover should in many cases generate tax liabilities larger than the regular income tax liabilities of companies that make even relatively restrained use of BEPS-style tax-avoidance techniques.[36] This suggests that the rate of an ACMT might be calibrated so as to yield revenues that are higher than those raised under current circumstances, in which BEPS is largely unconstrained, but not so high as to place

[28]To see the relative immunity of a turnover-based ACMT to this kind of tax avoidance, consider a mining subsidiary in a Country X that produces for export and sells to a related purchaser, during a taxable year, ore with a true fair market of $10 million. Assume further that the subsidiary's total deductible expenses, including interest, for the year are $9.6 million, so that its properly measured net income is $400,000. Finally, assume that Country X imposes a regular corporate income tax of 25 percent and backs this tax up with an ACMT of 1 percent of turnover.

If the taxpayer accurately reports the value of the product that it exports, its regular income tax liability will be .25 x $400,000, or $100,000. The taxpayer's ACMT liability for the year will be .01 x $10 million, which also equals $100,000. (It will not matter, therefore, whether the taxpayer pays the regular tax or the ACMT.)

Assume now, however, that the taxpayer reports a slightly below-market value for the ore that it sells, of $9.8 million. The taxpayer's ACMT liability for the year then decreases by 2 percent, from $100,000 to $98,000. The taxpayer's reported net income, however, is reduced from $400,000 to $200,000, and its regular tax liability is reduced *by 50 percent*, from $100,000 to $50,000. The regular tax liability is therefore far more sensitive to even a slight undervaluation of product sold than is the turnover-based ACMT.

[29]The countries include Argentina, Bolivia, Cambodia, Cameroon, Chad, Colombia, Democratic Republic of the Congo, Ecuador, El Salvador, Equatorial Guinea, Gabon, Guatemala, Guinea, Honduras, India, Ivory Coast, Kenya, Laos, Madagascar, Malawi, Mauritania, Mexico, Morocco, Nigeria, Pakistan, Panama, the Philippines, Puerto Rico, Republic of the Congo, Rwanda, Senegal, Taiwan, Tanzania, Trinidad and Tobago, and Tunisia. Michael Carlos Best, Anne Brockmeyer, Henrik Jacobsen Keven, Johannes Spinnewijn, and Mazhar Waseem, "Production Versus Efficiency With Limited Tax Capacity: Theory and Evidence From Pakistan," 123 *Journal of Political Economy* 1311, 1312 n.15 (2015).

[30]See generally Victor Thuronyi, "Presumptive Taxation," in *Tax Law Design and Drafting* (Vol. 1) (1996), at 10-14 (generally expressing preference for asset-based approach).

[31]EY, *Worldwide Corporate Tax Guide 2017* (2017).

[32]Cambodia, Cameroon, Chad, Democratic Republic of the Congo, Republic of the Congo, Cote d'Ivoire, Gabon, Guinea, Guyana, Honduras, Hungary, Madagascar, Mauritania, Morocco, Nigeria, Pakistan, the Philippines, Senegal, Tanzania, and Tunisia. This list may not be exhaustive.

[33]Summaries of the minimum tax regimes in each of the 19 countries are provided in an Appendix to this chapter.

[34]Best et al., note 29 above, at 1331-1332 (2015).

[35]IMF Country Report No. 16/83 (Mar. 2016) at 15.

[36]Consider, for example, a "limited risk" beverage distribution subsidiary of a multinational group in a lower-income country, which realizes $100 million of gross income. After deducting its cost of goods sold as well as royalties and service fees paid to an affiliate in a zero- or low-tax country, the taxpayer reports on its income tax return a net operating margin of 3 percent, leaving net income of $3 million. Assume also that the subsidiary deducts interest at 30 percent of net operating income, or $900,000, so that taxable income is $2.1 million. If the corporate income tax rate is 30 percent, the taxpayer's regular corporate income tax liability is $630,000. The taxpayer's alternative corporate tax liability, 1 percent of turnover, is $1 million; as this amount is higher than the taxpayer's regular tax liability, the taxpayer is liable for the alternative minimum tax rather than the regular tax liability.

politically untenable tax loads on inbound investors.

An argument typically raised against turnover-based taxes, including ACMTs, is that a turnover-based tax can undesirably increase investors' perceptions of financial risk. Under a turnover-based tax, a company faces the possibility of being subject to taxation even if the company incurs a loss, or earns only sub-normal profits. In theory, this risk, which is not posed by a net-income based tax, should to some extent operate as a disincentive to investment. This disincentive undoubtedly involves some social cost, but the higher tax collections made possible by the minimum tax provide offsetting social benefits. It seems quite plausible that, especially in lower-income countries, to the extent any disincentive to investment is raised under a turnover-based minimum tax, its social detriment would be outweighed by the advantages of more adequate corporate tax revenues.[37]

Another concern is that a turnover-based corporate tax would operate similarly to a consumption tax on the goods or services sold by the corporation, and therefore might be more regressive in its distributional effects than a tax based on corporate net income. Again, however, the low rates at which a turnover-based ACMT is likely to be applied, contrasted with the much higher rates at which consumption taxes like the VAT typically are applied, suggests that any regressiveness introduced to a tax system by an ACMT likely would be limited, compared to the social benefits made available from the additional revenues raised.

Politically, an ACMT, as a broad measure that targets tax avoidance of a number of different kinds, should pose an advantage over more narrowly directed measures like limitations on interest deductions, royalties, or service charges. Narrowly targeted restrictions on deductions are likely to be opposed especially ardently by companies that make intensive use of the particular deduction being targeted: for example, companies that historically have made extensive use of zero- or low-tax lending companies may fight particularly hard against the imposition of limitations on interest deductions. An ACMT, on the other hand, which seeks to limit base erosion regardless of the particular avoidance technique used by the taxpayer, may encounter fewer concentrated pockets of opposition.

Another potential advantage of an ACMT is that its relative administrative simplicity, and its tendency to avoid targeting particular taxpayer groups more than others, might lend itself well to internationally coordinated adoption, perhaps on a regional basis. Coordinated implementation of an ACMT might mitigate, to some extent, the pressures of tax competition that stand at the heart of base erosion and profit shifting, and thereby enhance prospects for the ACMT's successful performance. It may not be entirely unrealistic to see in the ACMT, imposed at a rate of about 1 percent of turnover, potential for establishing a norm of tax policymaking for lower-income countries, coordinated through regional tax compacts.[38] International agreement might extend to a commitment not to grant exemption from the minimum tax, even to taxpayers that are exempted from regular corporate taxation under tax holidays or other arrangements. Of course, the political feasibility of regionally coordinated ACMT policies remains to be determined, but it is a possibility worth exploring.

Historical Lack of Attention to ACMTs

Given the already fairly widespread use of the ACMT, and the obvious potential for the ACMT to address the kinds of avoidance that motivated the initiation of the BEPS process, it is striking that the minimum tax did not receive greater attention in the course of the BEPS studies. Early during the BEPS process, the IMF raised the potential benefits of AMCTs as a component of the effort to

[37] This is the fundamental argument of Best et al., note 29 above.

[38] The West African Economic and Monetary Union (WAEMU) provides member countries with the option of including an ACMT in their tax systems. See IMF Report on Mali, note 35 above, at 13.

control base erosion in developing countries,[39] but there appears to have been no serious follow-up to the IMF's suggestion by the OECD or any other intergovernmental body.

Possibly, the bluntness of the AMCT as an instrument for controlling tax avoidance placed it outside the political and intellectual boundaries of what the OECD might have been expected to explore during the BEPS process. A central, implicit element of the historical "international consensus" is that tax authorities should accept the burden of measuring taxpayers' net incomes with a high degree of precision, to prevent subjecting taxpayers to excessive taxation. Taxes based on turnover contradict this paradigm; instead, by their structure, they appear to elevate the goal of raising revenue above that of ensuring corporate taxpayers accurate measurement of their net incomes. The BEPS episode nevertheless suggests that some shifting of the historical priority, in the direction of certainty in raising public revenues, may be desirable in the interests of overall public welfare, especially in lower-income countries where the social benefits of enhanced corporate tax collections are likely to be especially pronounced.

The Need for Country-Specific Research

Not only did the BEPS process give little attention to the ACMT, but the scholarly tax literature seems not to have accorded it much detailed study and analysis. This may reflect that from the standpoint of a tax theorist, the ACMT is a fairly uninteresting creature: it is not based on the intellectual model of optimal taxation that has dominated scholarly tax analysis since the 1970s. Recently, by analyzing quantitatively the tradeoff between precision and administrability that the ACMT represents, the work of Michael Best and others[40] not only has forged new intellectual ground but also, ideally, will encourage additional research on the minimum tax. This effect would be welcome, since a program for expanding use of the ACMT, in lower-income countries and elsewhere, should be based on a larger body of empirical knowledge than currently is available.

Research should assess the historical performance of the ACMT both quantitatively and qualitatively, on a country-by-country basis. For example, in countries that have the tax, what percentage of taxpayers are covered by it, and what percentage of revenue is attributable to it? Has the ACMT been the subject of political controversy? To what extent if any is exemption of the tax afforded to start-up companies, and how have any start-up exemptions performed in practice? Under what other circumstances are taxpayers exempted from the ACMT (for example, are companies that are granted exemption from the regular corporate tax also routinely exempted from the ACMT)? Answers to all these questions would provide essential practical guidance with respect to whether expanded use of corporate minimum taxes based on turnover is likely to be of significant fiscal benefit to lower-income countries.

Additional Uses for Gross-Income Taxes

In exploring, immediately above, the possible merits of an alternative corporate minimum tax based on turnover, I described some important advantages of taxes based on gross instead of net income in preventing base erosion and profit shifting. Under gross-income taxes, no deductions are allowed, so the taxes are immune from profit-shifting through payments of interest, royalties, and service fees. In addition, gross-income taxes are much less affected than net-income levies by the undervaluation of sales revenues, for example in connection with

[39] A 2014 IMF staff report observes:

> One possible approach to bolstering the CIT [corporate income tax] base in developing countries is through some form of *minimum tax* (MT). An MT aims to protect revenue by charging tax on something — commonly turnover, book earnings or assets — that is less subject to manipulation than is taxable income, with overall tax payment then being the larger of liability under MT and under the standard CIT. Corporate MTs are already found in over 30 countries. Schemes differ quite widely, and can lead to considerable complexity and significant distortion: a charge on net assets, for instance, can reinforce debt bias, while one on gross assets may introduce distortions between firms with differing capital structures. Nonetheless, MTs have proved both useful and practicable in protecting domestic tax bases, and might also be addressed to combating aggressive international tax planning in relation to inward investment. They could, for example, address in a simplified, aggregate way the need for increased limitations on deductibility of certain cross border payments flowing from developing countries, that is seen by many observers.

IMF, "Spillovers in International Corporate Taxation" (May 2014), at p. 36.

[40] Best et al., note 29 above.

purchasing-company structures that might be used by natural-resource extractors operating in lower-income countries.[41] There are, to be sure, economic disadvantages of gross-income taxes, including the risk of imposing tax liabilities on investors even if the investors are not operating at a profit. Nevertheless, as argued above in connection with the alternative corporate minimum tax, there may well be situations where the administrative advantages of gross-income taxes outweigh their disadvantages.

In this discussion, I explore some important additional ways that countries around the world, including lower-income countries, regularly employ gross-income levies to avoid the administrative shortcomings of net-income taxes. These include the use of (i) royalties in natural-resource taxation; and (ii) excise taxes for hard-to-tax industries like telecommunications, banking, and insurance.

Natural Resource Royalties

The extraction of natural resources — both oil and gas and hard minerals — are very important to many developing countries, and revenues from extraction sometimes account for very large shares of countries' total government receipts.[42] Therefore, taxes on natural resource producers can constitute large proportions of producing countries' tax revenues. Moreover, the natural resources beneath the surface of a country typically are owned by the country's government, so that when the government imposes a tax on a producer that removes and sells part of the country's endowment of nonrenewable resources, the government acts not only under its taxing power, but also as proprietary seller of resources on behalf of the country's people. This consideration places a special public policy premium on ensuring that taxation of natural-resource producers in a country occurs effectively, and at levels high enough to reflect the full value of the resources that the government is, in effect, selling to the extractor.

Historically, governments have exacted revenues from natural resource producers in two basic forms.[43] One form is the royalty, usually expressed as a percentage of the fair market value of the product produced. So, for example, a royalty charged to an iron-mining company might be set at 10 percent of the fair market value of each ton of iron ore produced. Royalties are in effect taxes imposed on a producer's gross rather than its net revenues.

Royalties, however, can be seen as an economically blunt instrument for taxing natural-resource producers, since they can be imposed on producers even before they have begun to realize profits from their extractive activities. This risk can discourage companies from investing in extractive projects. To counter this effect, it has been customary for many years not to tax natural-resource producers only through royalties, but instead to apply a "fiscal mix" consisting in part of royalties, and in part of taxes based on net income. The net-income taxes used might consist of the country's regular corporate income tax, or they might consist of a special kind of income tax known as the resource rent tax (RRT). (Under an RRT, a resource producer is not taxed until the producer has earned a specified return on its capital investment in a project; the RRT therefore is seen as especially effective in mitigating investors' risk of premature taxation.[44])

The inclusion of income-based taxes, as well as royalties, in the typical fiscal mix for extractive projects has reduced disincentives to investment, but at the same time it has introduced serious, BEPS-related enforcement problems to natural resource taxation. Royalties, as taxes on gross rather than net income, are immune from the kinds of BEPS-style tax avoidance that involve deductions for interest expense, intellectual-

[41] Note 29 and accompanying text.

[42] For example, in many petroleum-producing countries natural-resource taxes account for well over half of government receipts; in Botswana mining revenues account for almost half, and in Guinea about 30 percent, of government receipts. See Philip Daniel, Michael Keen, Artur Świstak, and Victor Thuronyi, "Introduction and Overview," in *International Taxation and the Extractive Industries* (2017), at 1, 2.

[43] The ensuing discussion of natural resource taxation is highly simplified and is intended to permit readers to gain a basic understanding of the topic in a very brief format. Those seeking more complete information should see the comprehensive treatment in *International Taxation and the Extractive Industries*, note 42 above; see also Michael C. Durst, "Improving Natural Resource Taxation in Developing Countries," *Tax Notes Int'l*, Sept. 18, 2017, p. 1167.

[44] For a discussion of resource rent taxes (RRTs), see Bryan Land, "Resource Rent Taxes: A Re-appraisal," in *The Taxation of Petroleum and Minerals: Principles, Problems and Practice* (2010), at 256.

property royalties and related-party service fees. In addition, royalties are much less sensitive than income taxes to the understatement of the fair market value of the product that is produced.[45] In contrast, income-based taxes are highly vulnerable to profit-shifting through deductible payments. Natural resource projects can be heavily debt-financed, raising the possibility of large related-party interest deductions.[46] Natural-resource producers also often incur large costs for technical services, equipment, and supplies provided by related parties, all of which can involve BEPS-style profit-shifting.

Plainly, a tradeoff is presented between the use of royalties and income-based taxes in natural-resource fiscal regimes. Income-based taxes pose less disincentive to investment, but they are much more vulnerable than royalties to BEPS-style taxpayer avoidance. While views can differ, it is my impression that historically, policy-making in the natural resources sector has tended to under-appreciate the revenue losses arising from tax avoidance, and therefore to give excessive relative weight to the risk-mitigating advantages of income-based taxation. It may well be appropriate for fiscal regimes to give greater weight to royalties than they tend to do today.[47]

It should be understood, in this connection, that it is possible to structure royalties so that they offer investors at least some of the risk mitigation afforded by income-based taxes. For example, the rate of a royalty might be set to vary with the volume of production from a mine or field, and with the price level of the product being produced.[48] A variable royalty of this kind should be correlated to some extent with the profitability of a project, reducing the risk of inappropriately high taxation. Variable royalties, however, remain based on gross rather than net income, so that they should remain relatively immune to BEPS-style avoidance. Overall, variable royalties might be seen as a useful middle ground between royalties and income-based taxes.

Other Uses of Gross-Income Levies

Natural-resource production is not the only important industry in lower-income countries for which effective enforcement under an income tax is exceptionally difficult. For example, mobile telephone service providers tend to play important economic roles in lower-income countries. The companies typically are members of multinational groups; and they engage in a large variety of transactions, including borrowing, the obtaining of technical services and the purchase of equipment, with other members of their multinational groups. Over the years, many countries have responded to the difficulty of taxing telecommunications providers by applying excise taxes based on the purchase price of services rendered. Given the difficulties of applying income taxes to telecommunications providers, it seems inevitable that much of the taxation of the industry will need to consist of excise taxes.[49]

Other kinds of cross-border businesses that rely heavily on information and communications technology also pose problems of tax administration similar to those posed by mobile telephony. These include, for example, providers of software and of consulting services on-line;

[45] See the numerical example in Section II.A of Durst, note 43 above.

The OECD's report on BEPS Actions 8-10 attempts to alleviate the problem of related-party purchasing companies by endorsing the use of a so-called "sixth method" in valuing natural-resource and agricultural products for tax purposes. The sixth method accepts, as valid comparable selling-price information, publicly available posted price data, like for example the posted prices of particular grades of crude oil, or of metal ores. See OECD Transfer Pricing Guidelines (2017), at paragraphs 2.18-2.22. The sixth method, however, is likely to be of only limited use to tax authorities, since in many cases the valuation of natural-resource product requires difficult adjustments to posted product prices for factors like variations in ore or petroleum quality, distance of the mine or well from the marketplace, and whether the product is being sold at spot or under long-term contracts. Also, the sixth method doesn't address the problem of verifying the appropriateness of deductions taken by natural resource producers for expenses like interest, technical service fees, and the cost of equipment rented or purchased from related parties. Overall, despite acceptance of the "sixth method," the serious problems of transfer pricing enforcement for natural-resource producers remain largely unsolved.

[46] See, e.g., IMF Spillovers Report, note 39 above, at 20.

[47] See Michael Keen and Peter Mullins, "International Corporate Taxation and the Extractive Industries," in *International Taxation and the Extractive Industries*, note 42 above, at 11, 34: "[The availability of tax avoidance] may . . . mean tilting the balance between profit-based taxes and royalties further towards the latter than might otherwise be the case, on the grounds that monitoring deductible costs is harder than monitoring revenues."

[48] See Kimberly A. Clausing and Michael C. Durst, "A Price-Based Royalty Tax?" *Tax Notes Int'l*, Sept. 7, 2016, p. 803.

[49] See generally Thornton Matheson and Patrick Petit, "Taxing Telecommunications in Developing Countries," IMF Working Paper No. 17/247 (2017).

internet service providers; sellers of goods using electronic commerce; and social media sites. For these kinds of businesses, it appears impossible based on normal transfer pricing analysis to determine satisfactorily how much income should properly be taxed in the country where services or goods are consumed, and how much should be taxed elsewhere. Currently, much income from these kinds of businesses apparently goes untaxed in countries at all levels of economic development.

In Action 1 of the BEPS project, the OECD conducted an extensive review of what it labelled "the tax challenges of the digital economy." In large measure, the OECD's Action 1 report, released in November 2015, can fairly be characterized as an inconclusive study of whether the concepts of income taxation can satisfactorily be applied to digital businesses, or whether much of the tax burden of the digital economy must inevitably consist of gross-income based taxes. The Action 1 report found no consensus on this question, but noted that countries could, if they desired, experiment individually with the use of special measures including excise taxes in the digital field.

March 2018 saw the release of two important documents pertaining to taxation of the digital economy: (i) an Interim Report of the OECD,[50] and (ii) recommendations of the European Commission for legislation by the European Union.[51] The OECD's Interim Report indicated that lack of consensus continued to prevail, but that some countries had in fact adopted excises or similar taxes on digital services.[52] The OECD planned to continue its inquiry into the topic, issuing a final report in 2020. The European Commission recommendations included proposals for the adoption of excise taxes, although the extent of political support for the measures among EU governments appeared uncertain.

The global debate over how to tax the digital economy is not likely to be resolved through consensus in the near future. The industries that would be subjected to additional taxation wield considerable political power; also, serious questions are raised concerning whether additional taxation might unduly discourage desirable innovation, as well as the extension of digital services within lower-income markets. It seems unavoidable, however, that if the international digital economy is going to be taxed successfully, much of the taxation will need to take the form of excise taxes or similar gross-income levies.

The extension of the use of excise taxes will involve some costs. First, the economic burden of excise taxes probably falls relatively more heavily on consumers than does the burden of the corporate income tax. In addition, the targeting of excise taxes to particular industries but not others raises a danger of economic distortion.[53] But the fact remains that in a global economy increasingly characterized by the electronic dissemination of services and goods, greater use of gross income taxes by all countries, including lower-income countries, appears unavoidable.[54]

Conclusion

This chapter has described five different initiatives that offer lower-income countries realistic promise of greater control of base erosion and profit-shifting:

(i) improvements to transfer pricing rules and administrative practices, especially relating to the application of the Transactional Net Margin Method (TNMM);

[50] OECD, "Tax Challenges Arising from Digitalisation — Interim Report 2018" (2018).

[51] The European Commission proposals are available online.

[52] The OECD Interim Report, at pages 140-147, describes excise or similar taxes on electronic commerce imposed by India, Italy, Hungary, and France.

[53] This concern might be seen as especially important where external benefits are seen from the development of particular industries, like the provision of internet services in low-income areas. On the other hand, where industries generate external costs instead of benefits, as in say the tobacco and alcohol industries, the use of excise taxes seems economically especially appropriate, as evidenced by the very wide application of tobacco and alcohol levies around the world. See Mick Moore and Wilson Prichard, "How Can Governments of Low-Income Countries Collect More Tax Revenues?" ICTD Working Paper No. 70 (2017), at 13.

[54] See generally Michael C. Durst, "Limitations of the BEPS Reforms: Looking Beyond Corporate Taxation for Revenue Gains," ICTD Working Paper No. 40 (2015).

(ii) EBITDA-based limitations on interest deductions, as recommended by the OECD's BEPS Action 4 report;

(iii) actions to control treaty shopping and thereby prevent the inappropriate avoidance of withholding taxes;

(iv) expanded use by lower-income countries of an Alternative Corporate Minimum Tax, as a base-protecting overlay on a country's regular corporate income tax; and

(v) greater use of excise taxes in hard-to-tax industries, especially in the digital sector.

All of these measures could, I believe offer at least incremental revenue gains for lower-income countries, and in the aggregate, the revenue protections afforded by these measures might be substantial.

An important caution, however, is in order: none of these five measures against base erosion is discussed in this book for the first time. Instead, all these possible base-protection measures have been known to tax specialists for years, and in some instances they already are applied by countries in practice.

By and large, the fact that these measures are not used more extensively, especially by lower-income countries, does not reflect lack of technical expertise among tax policy-makers and administrators. Instead, the barriers to greater protection of the corporate income tax base by lower-income countries are rooted primarily in the political and economic pressures of tax competition.

For many years, investing multinationals have been eager to accept tax incentives, explicit or tacit, from countries of all levels of development; and governments, particularly those of lower-income countries, have refrained from erecting formidable barriers to profit shifting, apparently fearing the loss of foreign direct investment. The result has been the familiar race to the bottom, with countries relinquishing very large portions of their corporate tax bases to BEPS-style tax planning. Changing this situation will require more than legal and technical capacity in corporate taxation. It also will require mitigation of the pressures of tax competition which led to, and have sustained, the large incidence of profit-shifting from lower-income countries.

As discussed above, recent developments may to some extent be reducing the pressures of tax competition on lower-income countries. The reputational concerns of multinationals, for example, and enhanced CFC rules around the world (including, as described in Chapter 4, the new U.S. "GILTI" tax), may be removing from multinational groups some of the incentive to shift income from lower-income countries. These kinds of developments around the world, however, are likely to result in only limited reductions in pressures for base erosion from lower-income countries. Additional policy actions, taken by lower-income countries themselves, seem necessary if corporate tax revenues are to be increased substantially closer to desirable levels.

I am convinced, moreover, by the history of BEPS, and by the apparent continuing pervasiveness of tax competition, that as a political matter, lower-income countries will not be able to construct adequate safeguards for their corporate tax bases without some conscious assistance from multinational business interests. Today, as well as before the BEPS process, governments are unlikely to make serious attempts to increase corporate tax revenues if they fear the cost is likely to be the diversion of inbound investment to competing jurisdictions. In particular, as will be discussed further in the next chapter, I believe that satisfactory progress toward desirable levels of corporate taxation in lower-income countries will require deliberate forbearance by multinational companies from exploiting fully the economic leverage that tax competition affords them. For example, multinational companies, and their home-country governments, might refrain from opposing, and even seek to facilitate, moderate base protection measures like low-rate ACMTs in countries that are willing to adopt them.

In proposing this kind of forbearance from tax competition, I realize that I am raising important questions relating to the appropriateness of corporate actors basing their behavior on considerations other than the maximization of after-tax profits. It is impossible, however, to avoid these issues if the topic of corporate taxation in lower-income countries is to be treated

frankly and realistically. The bottom line is that substantial progress toward additional corporate tax revenues in lower-income countries will require mitigation of current pressures of tax competition, and there is no realistic alternative to some degree of corporate forbearance if that mitigation is to be achieved. The next and final chapter of this book will attempt to address this topic, in the course of what I hope is a pragmatic discussion of (i) the ethical challenges posed by the problem of corporate taxation in lower-income countries; and (ii) the ways both public and private actors might productively respond to these challenges.

Appendix to Chapter 5
Descriptions of Some Alternative Corporate Minimum Tax Regimes*
(Source: *EY Worldwide Corporate Tax Guide*)

Country	Description of Alternative Corporate Minimum Tax
Cambodia	Minimum tax. Minimum tax is a separate annual tax imposed at a rate of 1% of annual turnover inclusive of all taxes, except value added tax (VAT). If the [regular tax] liability exceeds the amount of the minimum tax, the taxpayer is not liable for the minimum tax. An exemption from the [regular tax] applies to the trigger period plus three years plus the priority period. The maximum trigger period is [a] QIP's [Qualified Investment Project's] first year of profits or the third year after the QIP earns its first revenue, whichever is earlier. The priority period, which is specified in the Finance Law and varies by project, may have a duration of up to three years. The taxpayer is also entitled to an exemption from the minimum tax (see Minimum tax) for as long as it retains its QIP status. QIPs are also eligible for import duty exemption with respect to the importation of production equipment, construction materials, raw materials, intermediate goods, and accessories that serve production.
Cameroon	Tax rates. The regular corporate income tax rate is 30% (plus a 10% additional council tax). For companies operating under the real earnings tax regime, the minimum tax payable is 2% (plus 10% additional council tax) of monthly gross sales (turnover). However, for companies subject to the real earnings tax regime that are in the administered margin sectors, which are the distribution of petroleum, domestic gas, milling, pharmaceutical, and press products, the minimum tax payable is 14% (plus 10% additional council tax) of the gross margin. The minimum tax payable is 5.5% for companies under the simplified tax regime. The minimum tax is creditable against corporate tax due for the current financial year. Operational phase. Incentives available during the operational phase (10 years for all companies qualifying for the incentives) include exemptions or reductions with respect to minimum tax, corporate tax, customs duties on certain items, and other specified taxes and fees. In addition, companies may carry forward losses to the fifth year following the year in which the losses are incurred.
Chad	The minimum tax is paid on a monthly basis at a rate of 1.5% of the turnover of the previous month. The payment must be made by the 15th day of the month following the month of realization of the turnover.
Congo, Democratic Republic of the	The minimum tax payable is 1% of the annual turnover for larger corporations. For small corporations with annual revenues of less than CDF10 million, the corporate income tax is set at CDF50,000. For average-sized corporations with annual revenues between CDF10 million and CDF200 million, the corporate income tax rate is 1% of the annual revenue for sales of goods and 2% for the provision of services.
Congo, Republic of the	The minimum tax payable is 1% of the annual turnover and cannot be less than XAF1 million (or XAF500,000 if turnover is less than XAF10 million a year). A 2% minimum tax is payable by companies that incur tax losses in two consecutive years. It appears that the 2% rate is applied to the sum of gross turnovers and products and benefits realized by the company in the most recent year in which it earned a profit. In general, the 2% tax is not deductible for corporate income tax purposes. However, in the company's first profit-making year after incurring the losses, one half of the 2% tax is deductible.

Appendix to Chapter 5
Descriptions of Some Alternative Corporate Minimum Tax Regimes*
(Source: *EY Worldwide Corporate Tax Guide*) *(Continued)*

Country	Description of Alternative Corporate Minimum Tax
Côte d'Ivoire	The minimum tax is 0.5% of turnover. For oil-producing, electricity, and water-producing companies, the rate is reduced to 0.1%. The rate is reduced to 0.15% for banks and financial companies and for insurance companies. The minimum tax may not be less than XOF3 million or more than XOF35 million. New corporations are exempt from the minimum tax for their first fiscal year, and mining companies are exempt from the minimum tax during the exploration phase.
Ecuador	Companies must make an advance payment of income tax equal to the sum of 0.2% of the equity of the company, 0.2% of the total costs and expenses deducted in the calculation of income tax, 0.4% of the total assets of the company and 0.4% of the total income subject to income tax. The equity and total assets are determined as of the end of the preceding fiscal year. The other amount is the total for the preceding fiscal year. The amount of the advance payment is calculated in the annual tax return. The advance payment is payable in two installments, which are due in July and September. To calculate the amount of the advance payment, the withholdings made with respect to the taxpayer in the preceding year are subtracted. The advance payment is considered a minimum tax. As a result, if no tax is payable for a fiscal year or the tax payable is lower than the advance payment, the advance tax is considered a final tax payment that may not be refunded or offset against tax in future years.
Equatorial Guinea	The minimum corporate tax is 3% of annual turnover for the preceding year. The amount of this tax cannot be less than XAF800,000.
Gabon	Tax rates. The standard corporate income tax rate is 30%. However, oil and mining companies are subject to tax at a rate of 35%. A reduced corporate tax rate of 25% applies to a limited number of companies. The minimum corporate tax payable is 1% of annual turnover, but not less than XAF1 million. The base for the calculation of the minimum corporate tax is the global turnover realized during the tax year. An exemption from the minimum corporate tax applies to the following companies: • Companies exempt from corporate income tax, as provided in the general tax code. • New businesses. • Newly incorporated companies or legal entities, for their first two years, regardless of their activities.
Guinea	Tax rates. The regular corporate income tax rate is 35%. Since the issuance of the amended Mining Code in April 2013, the rate for the mining sector is 30% (applicable to mining companies only; not applicable to subcontractors). The annual minimum tax payable is 3% of annual turnover. However, under the 2012 Financial Law, it cannot be less than GNF15 million or more than GNF60 million.
Guyana	Commercial companies, other than insurance companies, and commercial activities of a company carrying on both commercial and non-commercial activities are subject to a minimum tax at a rate of 2% of turnover if the corporation tax calculated as payable for the preceding year was less than 2% of the turnover of the commercial company. If, in any year, the corporation tax payable is calculated to be higher than 2% of turnover, the tax payable is limited to the corporation tax assessed. Consequently, the tax payable by a commercial company or with respect to the commercial activities of a company undertaking both commercial and noncommercial activities is the lower of 2% of turnover or corporation tax at a rate of 40%.

Appendix to Chapter 5
Descriptions of Some Alternative Corporate Minimum Tax Regimes*
(Source: *EY Worldwide Corporate Tax Guide*) *(Continued)*

Country	Description of Alternative Corporate Minimum Tax
Honduras	Alternative minimum income tax. An alternative minimum income tax applies to resident individuals or corporations with annual gross income in a fiscal year equal to or greater than HNL10 million (approximately USD433,463). The alternative minimum income tax is calculated by applying a rate of 1.5% to gross income. Legal entities must apply the ordinary rate of 25% to net income and apply the alternative minimum tax rate of 1.5% to gross income. The income tax payable is the higher amount resulting from these two calculations. The minimum income tax rate is reduced to 0.75% of gross income for individuals or legal entities producing or selling the following products or services: • Cement production and distribution. • Public utility services provided by state-owned companies. • Products and medicines for human use (at the importation and production levels). • Bakery-related products. Asset tax. An asset tax is assessed based on net assets (as defined in the law) reported in the company's balance sheet. The asset tax rate is 1%. Income tax may be credited against asset tax. If the income tax equals or exceeds the asset tax for the tax year, no asset tax is due. If the income tax is less than the asset tax, the difference is payable as asset tax. In such circumstances, the asset tax represents a minimum tax for the year.
Hungary	Alternative minimum tax. The alternative minimum tax (AMT) is calculated by applying the general rate of 9% to the AMT tax base. In general, the AMT tax base is 2% of total revenues, excluding any revenue attributable to foreign permanent establishments. The AMT tax base must be increased by an amount equal to 50% of additional loans contracted by the company from its shareholders or members during the tax year. If a company's AMT is higher than the corporate income tax otherwise calculated or the pretax profit, the taxpayer may choose to pay either of the following: • AMT. • Corporate income tax otherwise payable. In this case, the company must fill out a one-page form that provides information regarding certain types of expenses and, in principle, is more likely to be selected for a tax audit.
Madagascar	Tax rates. The standard corporate income tax rate is 20%. In general, the minimum tax is MGA100,000 plus 0.5% of annual turnover (including capital gains) for companies carrying out the following activities: • Agricultural. • Craft. • Mining. • Industrial. • Tourism. • Transport. This minimum tax equals 0.1% of annual turnover for fuel station filling companies. For companies engaged in other activities, the minimum tax is MGA320,000 plus 0.5% of annual turnover. The minimum tax applies if the company incurs a loss or if the corporate income tax calculated using the 20% rate is less than the minimum tax to be paid as stated above. Individuals or companies performing exclusively public market activities are exempt from minimum tax. Free zones' companies. Free zones' companies are exempt from corporate income tax for the first five years of their activities and are subject to corporate income tax at a rate of 10% for subsequent years. Large mining investments. Mining companies making investments over USD25 million can benefit from legal and tax incentives if they are eligible under a special law called Loi sur les Grands Investissments Miniers (LGIM). They are exempt from minimum tax for five years from the beginning of exploitation. The corporate income tax rates are 10% for owners of mining permits and 25% for the transformation entities.

Appendix to Chapter 5
Descriptions of Some Alternative Corporate Minimum Tax Regimes*
(Source: *EY Worldwide Corporate Tax Guide*) *(Continued)*

Country	Description of Alternative Corporate Minimum Tax
Mauritania	Tax rates. The regular corporate income tax rate is 25%. The minimum tax (impôt minimum forfaitaire, or IMF) is 2.5% of turnover. However, the tax may not be less than MRO750,000. Profits realized in Mauritania by branches of foreign companies are deemed to be distributed and, consequently, are subject to a branch withholding tax of 10% on after-tax income. The new investment code provides for a preferential tax regime, which is available to companies producing goods or services for export exclusively and companies working exclusively for them.
Morocco	The minimum tax equals the greater of the minimum fixed amount of MAD3,000 and 0.5% of the total of the following items: • Turnover from sales of delivered goods and services rendered. • Other exploitation income (for example, directors' fees received when the company acts as an administrator of another company, revenues from buildings that are not used in the company's activities, and profits and transfers of losses with respect to shared operations). • Financial income (excluding financial reversals and transfers of financial expenses). • Subsidies received from the state and third parties. The rate of minimum tax is reduced to 0.25% for sales of petroleum goods, gasoline, butter, oil, sugar, flour, water, and electricity. The minimum tax applies if it exceeds the corporate income tax resulting from the application of the proportional rates or if the company incurs a loss. New companies are exempt from minimum tax for 36 months after the commencement of business activities. Before January 2016, if minimum tax is applied because of the incurrence of tax losses or because the minimum tax amount exceeded the corporate income tax, the minimum tax could be offset against the corporate income tax due in the following three years. Effective from 1 January 2016, the minimum tax can no longer be offset against corporate income tax. Nonresident contractors may elect an optional method of taxation for construction or assembly work or for work on industrial or technical installations. Under the optional method, an 8% tax is applied to the total contract price including the cost of materials, but excluding VAT.
Nigeria	Minimum tax. Companies are required to pay minimum corporate tax if the minimum tax is greater than their actual tax liability. If a company's turnover is NGN500,000 or less, the minimum tax is the highest of the following: • 0.5% of gross profit. • 0.5% of net assets. • 0.25% of paid-up capital. • 0.25% of turnover of NGN500,000. If turnover is higher than NGN500,000, the minimum tax equals the amount computed in the preceding paragraph plus 0.125% of the turnover exceeding NGN500,000. The minimum tax does not apply to companies until the fifth year after the commencement of business. Companies engaged in an agricultural trade or business and companies with at least 25% imported equity capital are exempt from the minimum tax requirement.
Pakistan	Minimum tax. Resident companies and nonresident banking companies are subject to a minimum income tax equal to 1% of gross receipts from sales of goods, services rendered, and the execution of contracts, if the corporate tax liability is less than the amount of the minimum tax. The excess of the minimum tax over the corporate tax liability may be carried forward and used to offset the corporate tax liability of the following five tax years.
Senegal	Tax rates. The corporate income tax rate is 30%. The minimum tax (impôt minimum forfaitaire, or IMF) payable equals 0.5% of the turnover for the preceding tax year. The minimum tax may not be less than XOF500,000 or more than XOF5 million.
Tanzania	Alternative minimum tax. Companies reporting tax losses or utilizing loss carryforwards for three consecutive years must pay an alternative minimum tax at a rate of 0.3% on the annual turnover in the third loss year.

Appendix to Chapter 5
Descriptions of Some Alternative Corporate Minimum Tax Regimes*
(Source: *EY Worldwide Corporate Tax Guide*) *(Continued)*

Country	Description of Alternative Corporate Minimum Tax
Tunisia	The minimum tax payable is 0.2% of annual local turnover and 0.1% of taxable exportation turnover. The 0.2% minimum tax paid in 2014 may be credited against the corporate income tax payable for the next five financial years, but it is not refundable. The 2015 Financial Law eliminates the possibility of deducting the 0.2% minimum tax in the fifth year. Tax benefits, such as exemptions from certain taxes and duties, may be granted to companies established in a Tunisian Free Zone and to companies engaged wholly or partly in exporting.

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