

Corporate Tax Avoidance in
Developing Countries:
*An Unsolved Political-
Economic Problem*

Outline

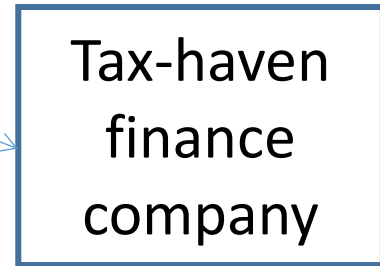
- Understanding base erosion and profit-shifting (BEPS)
- Centrality of tax competition: an interpretation of the rise and persistence of BEPS
- Two basic BEPS remedies:
 - Limitations on interest deductions
 - Enhanced transfer pricing method to ensure reasonable in-country income levels
- *Possible* long-term systemic remedy: Destination Based Cash Flow Tax (DBCFT)

What is BEPS?

- The shifting of profits, from countries where multinational groups conduct active business operations, through deductible payments to “hub” companies that the groups have established in tax havens
- Examples:
 - Tax-haven affiliate lends funds to group member conducting business in developing country; profit is shifted to haven through deductible interest payments
 - Tax-haven affiliate acquires legal ownership of valuable group trademark; profit is shifted to haven through deductible royalties
 - Tax-haven affiliate claims to serve as broker for transfers of services, supplies within group; profit is shifted to haven through service fees, purchase and rental payments

Simplified Diagram of Loan-Based BEPS Arrangement

Parent of group
contributes large
amount of cash



Finance company extends
loan to in-country operating
company



In-country
operating company
pays deductible interest
on loan, reducing in-country
tax burden.

In-country operating
company conducts
profitable business,
potentially generating locally
taxable income.

Tax Competition

- In world of mobile capital, governments (of countries at all levels of economic development) feel unable to impose taxation at significant levels on multinationals conducting business operations in their jurisdictions
- Against this, political voices typically insist that a country's laws at least nominally impose substantial taxes on inbound investors
- BEPS arrangements – which permit a country to retain high nominal rates of corporate income tax but then essentially forgo taxation through difficult-to-understand transactions – have evolved from these competing pressures

Tax Competition (cont'd)

- To some extent, governments afford inbound investors explicit exemptions from taxation (e.g., “tax holidays”), although these invite political criticism
- As a less transparent means of providing tax exemption, governments around the world have for several decades tacitly tolerated the use by MNEs of various “base erosion and profit shifting (BEPS)” structures
- Publicity from CSOs, journalists made increased visibility, resulting in

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https://www.yunbaogao.cn/report/index/report?reportId=5_1921

