

TAX TRANSPARENCY: THE NEW “NORMAL”

TRANSPARÊNCIA DE IMPOSTO: O NOVO “NORMAL”

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ABSTRACT: This article looks at the how governments and business will have to learn to operate in an environment which is characterized by increased tax transparency and a great focus by civil society and politicians on the taxes paid by multinational enterprises and high net worth individuals. It also discusses the outcomes from the G20 led Base Erosion Profit Shifting initiative and the debate over whether multinational enterprises are paying their fair share of the tax burden. It begins by looking at the economic environment which has shaped these initiatives and then examines what have been the main drivers of these changes. A concluding section sets out what are some of the implications for Brazilian multinational enterprises and the Brazilian Revenue Service.

RESUMO: Este artigo aborda o processo pelo qual os governos e a classe empresária terão de passar para aprender a operar em um ambiente caracterizado pelo aumento da transparência fiscal e pelo grande apelo político e social em torno da questão da tributação das multinacionais e dos indivíduos detentores de grandes fortunas. Ele também discute os resultados da iniciativa do G20 para combater a Erosão da Base Tributária e a Transferência de Lucros (Base Erosion and Profit Shifting - BEPS) e o debate acerca do montante de impostos pagos pelas empresas multinacionais e a justa repartição da carga tributária. Como ponto de partida, o artigo discorre sobre o panorama econômico no qual as iniciativas BEPS foram moldadas para, depois, examinar os principais vetores que influenciaram as mudanças ocorridas. Por fim, na sessão de encerramento, estabelece algumas das principais implicações do novo modelo para as multinacionais brasileiras e a Secretaria da Receita Federal do Brasil.

1. INTRODUCTION

The twenty-first century has passed through the ‘noughties’ and is in now in its teens. The teen’s tax environment, just like most teenagers, is often incoherent, sometimes unintelligible and is prone to excessive debate and controversy.

I should know, I’ve owned a couple of teens and they made managing the Organization For Economic Cooperation and Development’s (OECD) Centre for Tax Policy and Administration look like a walk in the park.

So before we talk about where tax transparency is heading, let’s look at the context of where we’ve come from.

The tax “norms” of the past typically involved taxpayers interacting with tax authorities in relation to their tax affairs, with public awareness of those affairs typically limited to disclosures resulting from litigation.

In the twenty-first century’s teen years, businesses’ and wealthy individuals’ tax payments have become an issue of greater public debate. This impacts not only taxpayers’ relationships with tax authorities but also their public profile, companies’ relationships with consumers and potentially impacts on a company’s earnings per share.

2. THE GLOBAL FINANCIAL CRISIS AS A DRIVER OF CHANGE

The global financial crisis and its outcomes include significantly increased government deficits, lowering of countries’ credit standing and sometimes harsh public spending cuts, all of which have had a significant influence on national and global tax policies.

These outcomes have caused politicians and their tax collectors to identify policies which could increase revenues, particularly from multinationals but also to a lesser extent from the activities of businesses operating purely within a country.

The twenty-first century has seen multinational businesses become truly global in their operations. Multinational Enterprises (MNEs) have global value chains (GVC) with partly-completed goods and services and internal trade flows occurring before the final goods and services are sold or leased or licensed to end consumers. The rise of the digital economy, with instantaneous global communications and financial flows means that the number and types of intra-group transactions have increased exponentially. The digital revolution has made it possible for businesses to interact commercially with consumers in countries while maintaining a more limited physical presence than was the case in the pre-digital era. These factors all influence the way in which governments can tax MNEs.¹

These factors have been present for some years, and the OECD has done significant work in various related areas. However, these issues were in earlier years either not as significant or not as urgent – at least not by today’s new standards. So the tax policy work of the OECD proceeded at a measured pace, in areas such as:

- Transfer pricing including transfer pricing of intangibles
- E-commerce

¹ See Chapter 12 in BRICS and The Emergence of International Tax Coordination, IBFD 2015

- Permanent establishments
- Beneficial ownership of companies and access to double tax treaties
- Hybrid instruments
- Exchange of information to counter tax evasion
- The links between tax evasion and other illicit activities
- Value Added Tax (VAT)

The techniques used were the well-trying mechanisms of discussion papers, commentaries, propositions to governments which lead to non-binding guidelines and best practices. But things took time.

In 2008, the work of policy development started to become a more important issue. By 2009, it became urgent and tax was a regular topic on G8² and G20³ agendas.

In 2013, the debate reached its fever pitch with the launch of the Base Erosion and Profit Shifting (BEPS) project.⁴ We are now in a period where the OECD is developing a whole series of recommendations and guidance for countries to consider implementing, with some countries already starting to take unilateral actions. At the centre of these G20/OECD initiatives have been the issue of transparency.

4. WHAT HAS DRIVEN THE TAX TRANSPARENCY DEBATE?

The cost of stimulus packages such as increased welfare payments meant that government deficits and gross debt rose significantly across most nations. Look at the figures today – even with Japan, the UK and the US all showing some positive signs, the global outlook is far from bright: According to the International Monetary Fund (IMF), almost all of the G20 members are projected to run a deficit in 2015. By 2018, the number of countries running a deficit is projected to decrease only marginally. This suggests that tax policies and tax enforcement will continue to be strict, with any stimulation through the business tax regime remaining highly targeted and selective.

² Group of Eight (G8) and is made up of leaders from Canada, France, Germany, Italy, Japan, Russia, the UK and the United States of America.

³ The Group of Twenty (G20) is the group of governments from 20 major economies: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom (UK) and the United States (US) with the European Union (EU). The EU is represented by the European Commission and by the European Central Bank. Spain is a permanent invitee of G20 and participates annually in G20 summits.

⁴ See www.OECD.org/tax/beps-reports.htm

Like a pendulum, many governments swung from stimulus to the opposite end of the spectrum, rapidly putting in place policy measures designed to replenish their treasuries by increasing tax revenues. That continues to this day; pretty much everywhere we look, in fact, we see not just stimulus and not just austerity, but rather a selective mix of the two.

In virtually every country we’ve experienced some form of revenue raising measures but also a reduction in numerous welfare and expenditure programs, even Brazil is now trying to cut back public expenditure.⁵

Media and commentators – including the new breed of tax “activists” - have questioned the basis for the spending reductions, including asking why the relevant programs could not be funded by extracting higher tax revenues from business and the well-off. Notwithstanding the fact that corporate taxes typically make up only eight percent of tax revenues in an average OECD country – the percentage is much higher in the Brazil-Russia-China-India-South Africa (BRICS) - media and commentators’ attention has included significant attention on MNEs and their perceived contribution to tax revenues.

At the same time, notably the BRICS, with the exception of Brazil, have also questioned the adequacy of their tax revenues generated from the activities of MNEs.

Awareness of taxes paid and the activities of MNEs have been influenced by two related developments which have kept tax planning in the spotlight.

First, there has been growing awareness that in some developing countries the taxes and government charges paid by MNEs have in part been taken by politicians and other intermediaries for their private and political purposes. This led to the development of the Extractive Industries Transparency Initiative (EITI) - which involves, notably, relevant MNEs being more transparent in the sense of making public disclosures of their operations in various countries including their payments to the various arms of government in those countries. These disclosures have occurred principally to enhance the probity and governance of countries in which the MNEs operate. But the concept of MNEs disclosing more about their taxes and government charges paid has been picked up in the broader tax fairness debate.

⁵ See Global Trends in Tax Systems, Jeffrey Owens, ITIC Special Report, June 2012

Secondly, the huge volume of disclosures in recent years of tax evasion by private wealthy individuals and entities, including the use of tax havens and tax secrecy jurisdictions, has increased the focus on the use of these countries by MNEs.

This raised consciousness has resulted in numerous concerns being expressed by politicians and others. These include:

1. Greater public discussion about taxes paid by MNEs by politicians, whether in governments or opposition parties. The discussions have included reviews by governments and inquiries by parliaments in numerous countries.
2. Examination of businesses' tax payments, especially those of MNEs, by non-government organisations (NGOs) interested in the welfare of emerging countries.
3. Greater identification by commentators of gaps in various tax treatments of MNEs, which leads into reporting of the impact of these gaps for particular entities.
5. A focus on perceived lack of fairness by MNEs, when politicians and commentators realise to their frustration that MNEs paying low taxes due to planning are probably acting in accordance with the letter of the tax law.
6. Various campaigns against particular MNEs with low effective tax rates taking up far more media space than informed discussion about any policy concerns.

Public confidence in the “fairness” of a tax system is critical if countries are to receive the vast majority of their revenues without active intervention from the tax authorities. The current global debate around whether MNEs are paying their “fair share of tax” and the international tax technical and policy issues of base erosion and profit shifting should lead to MNEs regaining the trust of the public and politicians.

Greater transparency between taxpayer and tax authority is a good thing as it will lead to fewer disputes, greater mutual understanding, and a relationship based upon cooperative compliance. But, greater transparency should not occur at the expense of weakening confidentiality rules. It's very important that confidentiality is maintained since transparency has to be built on greater mutual trust. Fear that commercially sensitive information could potentially be released could undermine that trust.

The need for greater transparency and more information should be matched with a more constructive dialogue between taxpayer and tax authority and MNEs. It may be time for Brazil to follow the lead of Russia in putting in place a cooperative compliance framework.⁶

It’s important that companies help policy makers understand that their tax profile is far more dynamic than may be interpreted by just looking at effective corporate income tax rate. Published effective tax rates only include corporate income taxes, which are often a small fraction of the total taxes companies have liability for or are responsible for collecting and remitting. Companies need to better communicate their economic and social contributions to the countries and local communities in the jobs, training, investment, exports, and social initiatives in addition to the total taxes they pay.⁷

5. CURRENT AND EMERGING TRANSPARENCY STANDARDS

Defining tax transparency

Tax Transparency has many meanings, and as a result can be somewhat confusing, if not misleading. First, transparency can refer to the transparency of the tax affairs of a particular taxpayer to the tax authorities on the basis of a strict implementation of the law. This type of transparency is confidential in nature. A second type of transparency is where taxpayer voluntarily provides information to the tax authorities over and above the statutory requirements. A more recent type of transparency and disclosure requirements are also being posed where company information on taxes paid is then made available in the public domain.

The OECD has for several years been focussing on transparency, particularly in its initiatives to counter offshore non-compliance by requiring and seeking new tools for tax authorities to know the full position of taxpayers,⁸ including the ultimate ownership of relevant income and assets. This sense of the word transparency includes the tax authorities knowing all the entities within a country which are controlled by a taxpayer and has broadened in recent years as tax authorities, considering the affairs of MNEs, have realised that they do not understand fully the profile of the MNE across its global activities. This is relevant as tax authorities might, in relation to particular items of income or expense, regard it

⁶ See “Balancing the Books”, by Jeffrey Owens, *Quantum* April 2013, pages 36-39

⁷ See “The David H. Tillinghast Lecture Tax Competition: To Welcome or Not”, by Jeffrey Owens, paper delivered at NYU Law School, Sept. 27, 2011

⁸ See OECD website: www.oecd.org

differently if they involve overseas entities affiliated with their domestic taxpayer which are located in low tax countries as distinct from overseas affiliates in high tax countries.

The transparency of taxpayer affairs to the tax authorities has been enhanced by the removal of bank secrecy and by more focused reporting requirements on aggressive tax planning or uncertain tax positions. So the tax authorities are seeking more information about the taxpayers' affairs by a greater focus on the more challenging, more risky issues, those with greater potential for tax controversy – to make their task more efficient. This involves initiatives such as in Australia, the pilot of Reportable Tax Positions, or the UK reporting of aggressive tax “schemes”, or the US disclosures of Uncertain Tax Positions.

With respect to public tax transparency, recent years have seen some commentators pushing for all companies to disclose more comprehensively the income they generate in every country through their subsidiary entities, and the taxes paid and assets owned in every country, with a view to enabling a greater public debate about their “tax fairness”. This debate has also been associated with discussions about the fairness of MNEs taking tax holidays and other concessions offered by developing countries. Developments in this area have occurred at both the multilateral and national levels

The Extractive Industries Transparency Initiative (EITI)

The EITI emerged as a global anti-corruption initiative to counter the exploitation by national governments and politicians of emerging countries taxes and royalty payments made by extractive industry MNEs. The EITI is a global coalition of governments, companies and civil society working together to improve openness.⁹

Launched in 2003 and then revised in May 2013, the EITI maintains what is known as the EITI Standard. Countries implement the EITI Standard to ensure full disclosure of taxes and other payments made by oil, gas and mining companies. These payments are disclosed in an annual EITI Report which allows citizens to see for themselves how much their government is receiving from their country's natural resources.

⁹ See <https://eiti.org/>

Those adopting the EITI standard are required to report payments made to both national and local governments, including profit taxes paid. There are also requirements for governments adopting the EITI standard to disclose payments they receive from companies. The G8 communiqué published in June 2013 stated that “The US, UK and France will seek candidacy status for the new EITI standard by 2014”.¹⁰

In addition, Canada will launch consultations with stakeholders with a view to developing an equivalent mandatory reporting regime for extractive companies within the next two years. Italy is seeking candidacy status for the new EITI standard as soon as possible, while Germany is testing EITI implementation in a pilot region in view of a future candidacy as an implementation country. Russia and Japan support the goal of EITI and will encourage national companies to become supporters. It is noteworthy that none of the BRICS, including Brazil, participate in the EITI. The current corruption scandal in Petrobras may encourage Brazil to join the EITI.

There is a parallel development in the EU where the accounting directive on transparency and accounting introduces new reporting requirements for both listed and non-listed large companies engaged in either the extractive industry or in the logging of what are described as “primary forests”.

Also of relevance is the European Commission Country Requirements Directive (CRD IV) and country-by-country (C b C) reporting proposals. The CRD IV proposals provide that European banks and other institutions regulated under CRD IV should publically disclose entity names, nature of activities and geographical location, turnover, number of employees as an annex to their financial statements, on a country by country basis.¹¹

In addition, from the same date, CRD IV regulated Institutions must disclose pre-tax profit or loss, taxes paid and subsidies received on a country-by-country basis.

Over the course of the year, the Commission will review these additional three disclosures provided by the banks and assess whether such information should be required to be publicly disclosed from 2015 onwards. Specifically, the Commission will consider any

¹⁰ See https://www.g7germany.de/Webs/G7/DE/Home/home_node.html

¹¹ See http://ec.europa.eu/taxation_customs/index_en.htm

adverse implications of public disclosure on the areas of competitiveness, levels of investment, availability of credit, economic impact and broader financial stability.

Country by Country reporting standards

The OECD issued in September 2014 a revised chapter of the OECD Transfer Pricing Guidelines, which sets forth a three-tier approach for transfer pricing documentation that includes a framework for a master file and local file and a template for C b C Report.¹²

The OECD issued in April 2015 guidance primarily on implementation issues related to the C b C Reported, addressing the following matters:

- The timing of preparation and filing of C b C reports
- Those multinational corporation (MNC) groups required to file C b C reports
- The conditions for obtaining and use of the C b C reports by jurisdictions and
- The framework for government-to-government mechanism to exchange the C b C reports.¹³

While the guidance relates primarily to the C b C Report, it does include the recommendation that the master file and local file requirements be implemented through local country legislation or administrative procedures and the MNE groups file the master file and local file directly with the tax administration in each relevant jurisdiction under the requirements of such administrations.

The guidance recommends that the first C b C report be for the first fiscal year beginning on or after 1 January 2016. The C b C report would need to be filed within 12 months of the close of the fiscal year.

MNC groups with annual consolidated group revenue in the immediately preceding fiscal year of less than €750 million will not have to do a C b C (this excludes approximately 85-90% of MNC groups from the C b C reporting requirement).

¹² See Action 13, Guidance on the Implementation of Transfer Pricing documentation and Country by Country Reporting, OECD September 2014.

¹³ See Action 13, Country by Country Reporting, Implementation Package OECD April 2015

The results of Action 13 are scheduled for review in 2020 and the OECD indicated that it is the intention of the countries participating in the BEPS project to reconsider the appropriateness of this revenue threshold at that point. That review also will include whether additional or different data should be required to be reported.

This is an important step forward in relation to tax transparency debate, although the very high threshold and the fact that the information will be exchanged under tax treaties may in practice limit the usefulness of C b C for less developed countries (LDC).

Not all developments in this area have been multilateral, however; some have been purely national affairs; in Australia, for example, a key example is the recently enacted requirement, one of the last actions of the previous Labour government, to require the Australian Taxation Office (ATO) to publicly disclose, in relation to companies and corporate tax entities generating in excess of \$100M of gross income in the 2013-14 year, the taxpayers’ gross income, taxable income, and taxes paid. Australia, in this regard, is following the lead of Denmark, but of no other country in terms of such widespread public disclosure by all companies.

A second key country base “industry-focused” piece of legislation is The Dodd–Frank Wall Street Reform and Consumer Protection Act - more commonly referred to as “Dodd-Frank”. This was signed into federal law by President Barack Obama in July 2010. Although I describe it as “National”, as a piece of United States legislation, it’s important to recognize its wider geographical impact due to the fact that it applies to all Securities and Exchange Commission (SEC)-registered extractive companies, both upstream and downstream.

Echoing the sentiments laid out in the charter document of the EITI, President Obama welcomed the Dodd-Frank Act warmly in his signing speech, saying *“We also know that countries are more likely to prosper when governments are accountable to their people. So we are leading a global effort to combat corruption, which in many places is the single greatest barrier to prosperity, and which is a profound violation of human rights. That’s why we now require oil, gas and mining companies that raise capital in the United States to disclose all payments they make to foreign governments.”*

Section 1504 of the Act requires that SEC registered extractive companies file an annual report with SEC which includes disclosure of all payments of larger than \$100,000 by the company, its subsidiaries or any entity under its control. This includes payments to sub-National government.

The definition of payments was enlarged in late 2012 and now includes "taxes, royalties, fees (including license fees), production entitlements and other material benefits". Interestingly, Dodd Frank provides absolutely no exceptions to the requirements when foreign law precludes such a disclosure or where the information is deemed to be commercially sensitive. The disclosures made under Dodd-Frank are made publically available, just as they are under the EITI.

Exchange of information: an essential support for tax transparency

Understanding the different communication channels and methods by which this information is exchanged between tax authorities around the world is essential to understanding the new transparency environment.

Sometimes it's useful to steal someone else's words when covering a subject; in this case, I'll use the words of the OECD's secretary general (and my old boss!) who said that "*What we've seen in the area of information exchange has been nothing short of a revolution*".

Today, more than 1,900 information exchange relationships meeting the OECD's standard exchanges on request exist. More important though is the rapid movement towards the multilateral and automatic exchange of tax information. This has gone from concept to reality in just 5 short years. Much – but certainly not all - of this activity is driven by the globalization of the US Foreign Account Tax Compliance Act (FATCA) regime.¹⁴

In terms of current developments, the most recent G20 meetings saw all G20 countries, including Brazil, endorse the introduction of multilateral, automatic information exchange and a new single global standard for automatic exchange of information (the Common Reporting

¹⁴ See OECD: <http://www.oecd.org/tax/transparency/oecd-secretariat-general-report-tax-taxmatters-lisbon-november-2014.pdf>

Standards). This standard is broadly based upon the FATCA, but stripped of specific US features.

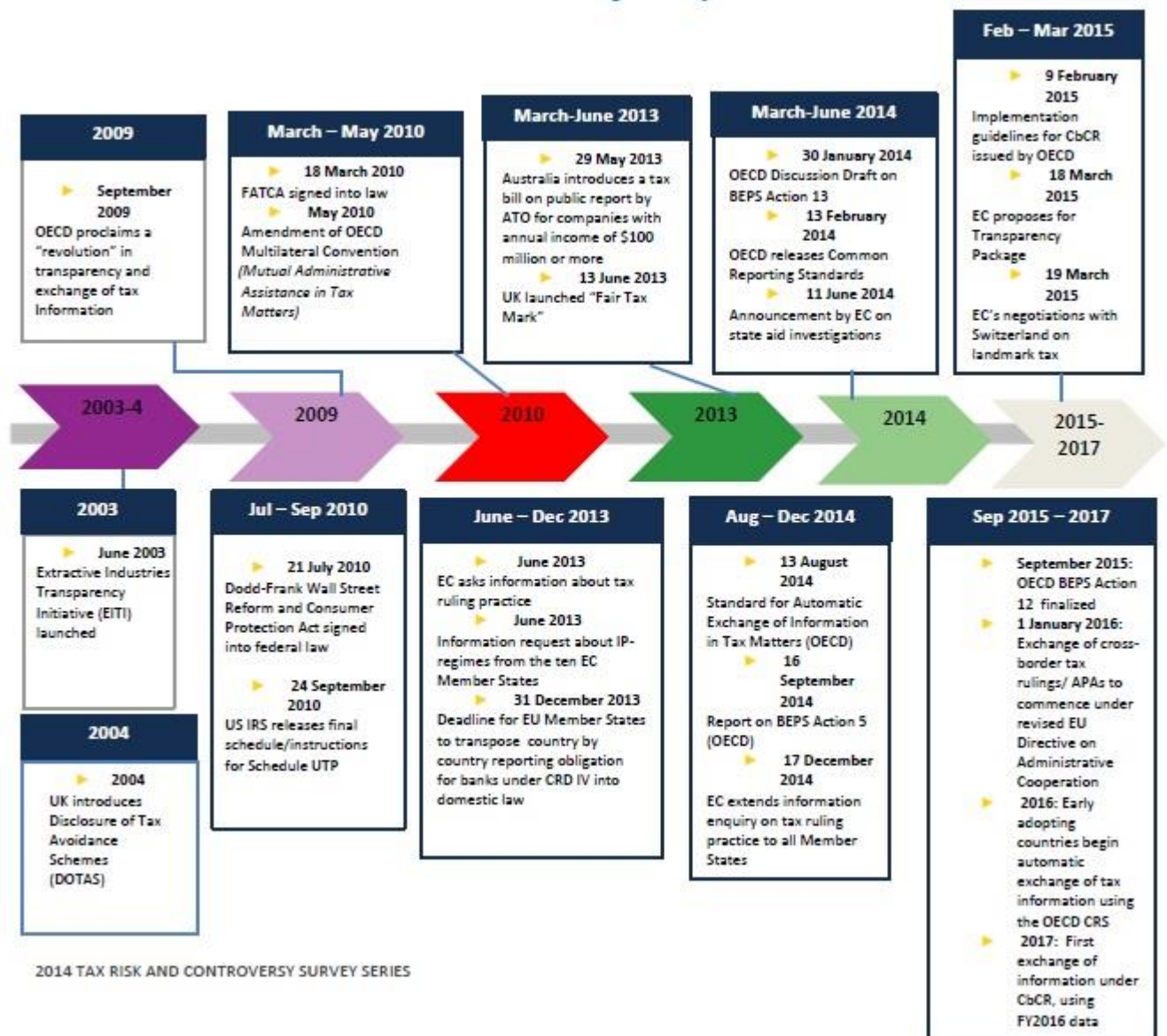
The vehicle for much of this information exchange will be the OECD’s Multilateral Convention.¹⁵ This Convention was opened to all countries in 2011, and provides for the exchange of information, simultaneous tax examinations, tax examinations abroad, assistance in recovery and measures of conservancy, and the service of documents. Importantly, it can also facilitate joint audits. It covers all taxes and compulsory payments to the general government other than customs duties.

The Convention now has more than 80 signatories, including all the G20 members; recent signatories include countries as diverse as Austria, India, Luxembourg, Kazakhstan, Singapore, China and Switzerland.

Box I provides a summary of how the transparency agenda has developed since 2009. What are the implications for Brazil of the developments?

¹⁵ See OECD: <http://www.oecd.org/ctp/exchange-of-tax-information/conventiononmutualadministrativeassistanceintaxmatters.htm>

Box I: The transparency timeline



Countering Harmful Tax Competition: The Role of Tax Transparency

Governments have recognized that greater transparency can be an effective way to deal with harmful competition. Aggressive tax reporting competition, or what the OECD called in 1998 harmful tax competition, is referred to in Action 5 of the Action Plan endorsed by the Heads of State at the G20 St Petersburg Summit in September 2013. This states:

"ACTION 5- Counter Harmful Tax Practices More Effectively, Taking Into Account Transparency and Substance.

Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and

on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework.”

It is useful to go back to the 1998 report to see how Harmful Tax Competition was defined. Box II reproduces the main criteria.

Box II

KEY FACTORS IN IDENTIFYING AND ASSESSING HARMFUL PREFERENTIAL TAX REGIMES FOR THE PURPOSES OF THIS REPORT

a) No or low effective tax rates

A low or zero effective tax rate on the relevant income is a necessary starting point for an examination of whether a preferential tax regime is harmful. A zero or low effective tax rate may arise because the schedule rate itself is very low or because of the way in which a country defines the tax base to which the rate is applied. A harmful preferential tax regime will be characterised by a combination of a low or zero effective tax rate and one or more other factors set out in this Box and, where relevant, in this section.

b) “Ring fencing” of regimes

Some preferential tax regimes are partly or fully insulated from the domestic markets of the country providing the regime. The fact that a country feels the need to protect its own economy from the regime by ring-fencing provides a strong indication that a regime has the potential to create harmful spill over effects. Ring-fencing may take a number of forms, including:

- a regime may explicitly or implicitly exclude resident taxpayers from taking advantage of its benefits.
- enterprises which benefit from the regime may be explicitly or implicitly or implicitly prohibited from operating in the domestic market.

c) Lack of transparency

The lack of transparency in the operation of a regime will make it harder for the home country to take defensive measures. Non-transparency may arise from the way in which a regime is designed and administered. Non-transparency is a broad concept that includes, among others, favourable application of laws and regulations, negotiable tax provisions, and a failure to make widely available administrative practices.

d) *Lack of effective exchange of information*

The lack of effective exchange of information in relation to taxpayers benefiting from the operation of a preferential tax regime is a strong indication that a country is engaging in harmful tax competition.

The no or low effective tax rate is the entry requirement and is not in itself a sign that the regime is harmful. Transparency and Exchange of Information are ways to address the potential harm to a treaty partner's tax base since they help the home country to take defensive measures. The key criteria, however, is the ring fencing, but this is narrowly defined as discrimination against resident tax payers by excluding them from preferential regimes. The idea was that this would make it more costly in terms of revenue lost for governments to introduce preferential regimes since they would have to apply both to resident and non-resident taxpayers. At the time when the report was drawn up there were a number of such regimes in the OECD area and in particular the Irish 10% regime that applied to only non-resident corporations. The underlining premise of the 1998 report was that to get the full benefits of tax competition required setting out an agreed set of international rules on what is "fair" and what is "unfair" and ensuring that there was transparency both on the part of governments and business. The analogy was made with free trade, where governments accept that getting the full benefits of free trade required guidelines on what was acceptable and what was unacceptable in the way in which countries compete.¹⁶

Within the constraints of its mandate the 1998 initiative was successful. 47 regimes were reviewed and those regimes that were found to be harmful were either eliminated or redesigned. Nevertheless, between 2011-2012 the project was effectively put on hold since some OECD countries claimed that the Harmful Tax Forum had achieved its objectives and

¹⁶ See "The David H. Tillinghast Lecture Tax Competition: To Welcome or Not", by Jeffrey Owens; paper delivered at NYU Law School, Sept. 27, 2011

therefore could be terminated: fortunately other countries felt that more work remains to be done.

The parallel EU Code of Conduct exercise was launched at roughly the same time and addressed similar issues, but in the context of a single European market and with more emphasis on the economic rather than legalistic analysis. The criteria used by the EU to identify harmful regimes put a much greater emphasis on the relative rate of tax that applied within a preferential regime and on whether an activity had “substance”. Again, the Code of Conduct group was successful in that almost all of the regimes that it identified as harmful were dealt with.

Today, the key question is whether the BEPS initiative will help the OECD and EU to reinvigorate this work?

Over the last 3-5 years we have seen countries designing many preferential regimes that conform to the letter of the OECD and EU codes but not with the spirit. In particular we have seen an increasing number of regimes put in place to attract R&D and intangibles, the latest example being the patent boxes which are now being increasingly used by European countries. Both the OECD and EU are currently examining the Patent Boxes to see whether they can be classified as potentially harmful.

Why are Patent boxes important? Because of the revenue potential. For large multinationals their wealth lies not in the physical products that they produce; it is the knowledge that lies behind these products that generate their wealth and therefore the tax base. As an increasing part of the corporate tax base becomes more mobile, countries will be more tempted to offer no or low tax regimes to attract these activities to their jurisdiction. The concern here is not just about shifting the tax base but also that such regimes distort the location of activities with decisions being driven not by real underlying economic factors but by tax.

So what should the G20 do to address harmful tax practices? First, there needs to be a “buy into” approach set out in the 1998 report by non-OECD G20 countries, so that the G20 can show leadership and which would encourage other countries outside of the G20 to follow their example. Secondly, there needs to be a commitment to review the criteria and, in particular, whether the ring fencing criteria needs to be extended to cover regimes such as the IP box (it is very unlikely that under the current criteria the UK regime would be classed as

harmful). Thirdly, a more robust monitoring system needs to be put in place, which could parallel the peer review process created by the Global Forum on Tax Transparency and Exchange of Information. Here the EU code of conduct group could play a key role.

As regards the scope of the definition of harmful regimes, it may be helpful to look again at what the 1998 report referred to as other factors in identifying such regimes. These included: the artificial definition of the tax base itself; failure to adhere to international standards, especially on transfer pricing; the use of a territorial regime with weak anti abuse provisions; negotiable tax rates and bases; a wide network of tax treaties without strong anti-abuse provisions; and regimes which are widely advertised as tax minimisation vehicles which are purely tax driven without any substance. On this last issue of substance, both the EU code group and the OECD's Harmful Tax group are examining how to define "substance". This is not an easy task, given the increasing digitalisation of our economies and the increased importance of intangibles. There is, however, broad agreement that countries need to be more transparent on the preferential regimes that they provide to companies. When the G20 heads of State meet in November, they will be asked to endorse a recommendation that government should automatically exchange information with their treaty partners on preferential regimes which are potentially harmful.

What are the implications of this move to transparency for Brazilian MNEs and the Revenue Service?

Brazilian MNEs operating abroad and MNEs operating in Brazil will need to learn to live in a more transparent environment where whatever is disclosed to one tax authority is likely to be shared with other authorities. This will force them to be more consistent in the information they share with tax authorities, which in turn will require a great centralization of the tax policy function in headquarters. They will also need to decide how far some or all of this information should be put in the public domain, on a voluntary basis. It's likely that once C b C information is circulating, the pressure will be on to publish it so MNEs need to anticipate this next stage and to assess how this may influence their reputation with consumers, with governments, with suppliers and with their employees.

The Brazilian Revenue Service will also have to learn to live in a more open and cooperative environment by:

- being more prepared to engage business in the development of legislation and its implementation
- moving towards a more constructive dialogue with taxpayers
- being willing to share its risk management strategies

The Revenue Service will have to up its game on exchange of information: an area where it has little practical experience in comparison to other countries. It will have to extend its network of Tax Information Exchange Agreements (TIEAs), upgrade its existing treaties and put more resources into the competent authority function.

Both government and business have a shared interest in making this move towards better tax transparency a success, since it will help restore trust on the part of citizens in the operation of the tax system.

6. CONCLUSIONS

This article has provided a broad overview of how recent international initiatives are creating a more transparent tax environment within which taxpayers and governments are going to have to learn to operate within. Adapting to this new environment will initially be challenging. Business will have to invest in setting up new information reporting requirements and will have to learn to justify their approach to tax planning, ensuring that any schemes are not only consistent with the strict letter of law but also with the spirit of the law. They will also have to reconsider how they use tax havens and ensure that tax is paid where value is created. Governments will also have to change their approach to taxpayers: engaging them in the formulation of tax policies and their implementation and seeing business as a partner rather than an adversary. All of this will require developing a more constructive and open dialogue between tax administrations and taxpayers and a relationship which is built on trust. Even though the transition to this new type of relationship may be difficult, the outcome should be greater certainty for business and government, lower compliance and administrative costs, less disputes and a regaining of public trust in MNEs.