GLOBAL FINANCIAL INTEGRITY

May 13, 2016

RE: **<u>Testimony at Hearing May 13, 2016</u>**
<u>on IRS REG-109822-15: Country-by-Country Reporting</u>

Thank you for the opportunity to testify on this globally significant topic today. My name is Heather Lowe, and I am Legal Counsel and Director of Government Affairs at Global Financial Integrity, a research and advocacy organization based in Washington, DC that focuses on curtailing the movement of illicit money, with a specific focus on its effect on development and developing countries.

I am also both a Steering Committee member of the Financial Accountability and Corporate Transparency Coalition (FACT), and one of the primary draftsmen of FACT's public submission on the proposed rule, although many people here today weighed in.

I'd like to begin by saying that we are very pleased to see the U.S. moving so quickly on this issue. We welcome the Administration and IRS's decision to implement what the U.S. agreed to under the OECD BEPS process in this area, and not to water that down. That is extremely important.

However, as I and others noted when we took part in the public consultations on this issue at the OECD level, there are certain things that can be done to make this new rule more effective, and there are a few things in the proposed rule that were not fully fleshed out at the OECD level which could use some attention.

To that end, I would like to address the following topics:

1. The types of information to be included on the Form.
2. How employees are counted.
3. Identifying numbers.
4. The scope of subsidiaries to be included in reporting.
5. The need for the reports to be publicly available information.

1. The types of information to be included on the Form.

The categories of information to be provided on the CBCR Form are, of course, a central issue. We agree with the proposed categories of information to be collected, although as we have noted in our written submission, we believe that sub-section (iv) should refer to "Total income paid on a cash basis in *each tax jurisdiction*", as opposed to "all tax jurisdictions", given that the information in the report is intended to be provided on a country by country basis.

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In addition to the categories of information included in the proposal, we recommend the inclusion of two additional categories of information:

- Deferred taxes, and
- Uncertain tax positions.

These categories of information were explicitly excluded from the reporting requirements in the proposal, but it is our opinion that they should be included because they are indicators of exactly the types of profit-shifting risk that CBCR reports are intended to identify.

Uncertain tax positions represent tax positions that companies believe have less than a 50% chance of withstanding an IRS challenge. The risk-appetite associated with those positions is patently obvious, and in which countries MNCs have subsidiaries with substantial transactions in this gray area are an indicator of profit-shifting risk.

With respect to deferred taxes, MNCs often shift profits to other countries and then defer the payment of taxes on those profits, making deferred tax information a possible indicator of profit shifting. Over time, the information can provide a marker of any changes in profit-shifting patterns, which is also very valuable information in determining whether anti-avoidance measures are having the necessary effect.

2. How employees are counted.

To avoid creating misleading and contradictory employment data, we believe that the final rule should allow U.S. multinational groups to count as employees only those people for whom the company pays payroll, social security, or other employment taxes, or people for whom that would be paid if the individuals were employed by the MNC in the U.S.

In particular, we are concerned with the treatment of "independent contractors." Currently, the proposed rule states that a parent entity "may" count as its employees the "independent contractors that participate in the ordinary operating activities of a constituent entity." It offers no additional guidance on the meaning of "independent contractor" or "ordinary operating activities."

This approach creates a legal and logical inconsistency. The U.S. tax code currently has a detailed body of law distinguishing between "independent contractors" and "employees" for tax purposes, while the rule proposes to allow professed "independent contractors" to be treated as "employees". This approach will to confuse U.S. tax law unnecessarily, and introduces significant uncertainty as to who an MNC is or is not including in its numbers.

Why is this? Consider a situation in which a parent company hired independent contractors to its accounting department for temporary help. Those independent contractors worked on preparation of several subsidiaries' accounting and tax filings. Given that accounting would probably be considered an "ordinary operating activity" of each of the subsidiaries, the parent could conceivably claim that these independent contractors were employees of those subsidiaries, which they clearly are not. Opening the door to this sort of distortion, artificially inflating the employment numbers for subsidiaries, creates a misleading picture of offshore operations.

In addition, one common tax avoidance tactic is for multinationals to form shell entities in tax havens and hire corporate service providers, law firms, or financial institutions to provide the shell entities with a president, manager, or other officers. Allowing the parent entity to treat those nominee individuals as “employees” would not only artificially inflate its employment figures in the tax haven, but also completely distort the meaning of the word “employee.” So that’s an issue as well.

3. Identifying numbers.

The proposal also states that TINs will be required for each MNC parent and entity subject to reporting. This is important, as subsidiary names can be similar which can lead to confusion. We have also recommended, however, that the final rule require each parent entity to provide a Legal Entity Identifier (LEI) for itself and each constituent entity, using the new international system for identifying individual business entities. We have provided additional detail about the system in our written submission, including information about the active involvement of Treasury, the Fed, and other parts of U.S. government in the creation of this system.

LEI use would simplify the compiling and analyzing of CbC reporting data for specific business entities, especially for foreign governments who do not have access to the U.S. government’s TIN records. LEI numbers and entities are open source information that can be freely accessed by any one, and any government, worldwide.

4. The scope of subsidiaries to be included in reporting.

While I believe Oxfam will be discussing this issue in greater detail, we are very concerned about the proposal to limit reporting to consolidated entities alone. We are of the strong opinion that reporting should cover all entities that would be accounted for under the equity method, which would provide a much more complete picture of the corporate group, and provide for a much more accurate picture of where profit-shifting may be occurring. A major point of this requirement is to help identify where one should be looking for aggressive or abusive transfer pricing, and the more complete the information is to guide that assessment the more appropriate (and therefore less burdensome) the inquiries from tax authorities will be.

5. The need for the reports to be publicly available information

Finally, Country-by-Country Reporting has the potential to be a game-changing measure in the fight against profit shifting by multinational companies. The most important step that can be taken to turn the potential into reality is for CBCR information to be made publicly available, ideally as data published on an MNC’s website as has been proposed in the EU.

Why is this so critical? Despite being one of the most well-resourced tax authorities in the world, the U.S. cannot address this problem, which has cost the U.S. an estimated $111 billion in corporate tax revenue from 1983 to 2012, on its own. The IRS already has all of this CBCR information, and more, for every US-based MNC from their CFC filings, and yet profit shifting out of the U.S. has grown substantially in recent years. You will know better than I why we have not gotten on top of profit shifting, but a part of the problem is that it takes a number of countries acting in concert to address it. I have no doubt that another part of the problem is that the IRS has a great deal of increasing responsibility, with diminishing budget and staff, and I’m afraid that is unlikely to improve anytime soon

Making CBCR information publicly available addresses both of these challenges. It is the most cost efficient and effective way to ensure that other countries have the information they need to work with the U.S. in order to combat the profit shifting that is depleting the U.S. Treasury and contributing to our deficit, while at the same time significantly reducing the cost and resources that the IRS would need to allocate to administering an information sharing system.

Not to be overlooked, another extremely important benefit would be ensuring that Congress has the information it needs to analyze the profit shifting problem, to determine whether national and international measures are effectively reducing the activity, and to determine whether additional measures are necessary.

Thank you for the opportunity to speak today.

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