Comments on the Agenda for the
23rd Session of the Committee of Experts on International Cooperation in Tax Matters

TO: United Nations Committee of Experts on International Taxation Submitted via email to taxcommittee@un.org

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I have followed developments in the international taxation area for many years, including more than thirty years practicing with major accounting firms beginning in the late 1960s and as an academic following my first retirement in 2001. I have taught various international tax courses for much of the past two decades, written many articles,[1] and have actively participated in the work of the BEPS Monitoring Group over the past eight or nine years. As it has been almost fifteen years since I have been a paid advisor, my "agenda" is better tax administration and a fairer economic outcome for all stakeholders and not simple lobbying for specific interests.

In the course of my research and writing, I have noted that many multinational profit-shifting structures book transactions, and thus the profits from those transactions, through tax haven and other low-taxed group members despite there being few or no employees within those group members. The employees who actually generate such profit are in the home country of the multinational or in other countries where the multinational has regional or local management and operating personnel.

Looking at this issue from the U.S. perspective, I have seen that the U.S. tax authorities for unknown reasons have not attempted to impose a direct tax on such profits despite there being "tools" within the U.S. tax law to do so. In the case of the United States, the principal tool is the "effectively connected income" rules.[2] Most other countries have similar rules, though they are more typically referred to as taxation of non-residents that earn income attributable to a permanent establishment.

I hope the following brief comments will be helpful to the members of the Committee.

Potential new item: Application of countries' domestic tax law to non-residents.

One of the driving forces behind Pillar Two has been the reality that the personnel and activities that have earned such profits have been located in the home countries of MNEs or in the countries in which these MNEs conduct operations.[3] Likely, in many cases, transfer

[1] My articles are available at http://ssrn.com/author=1782073.
[2] Sometimes with co-authors, I have written a series of articles over the past six years that have dealt with various aspects of how the U.S. effectively connected income rules should be applied to multinational profit-shifting structures. These articles and links to them are provided in a listing at the end of this submission.
[3] As evidence of this, Deputy Assistant Secretary Kimberly Clausing, in her work prior to joining the Treasury Department, calculated that roughly two-thirds of the real activities that earned zero and low-taxed profits recorded in eleven tax havens took place within the United States. Presumably the other one-third of real activities took place within other mid- to high-tax countries where MNEs conduct their worldwide businesses. *See* Kimberly A. Clausing, "5 Lessons on Profit Shifting From U.S. Country-by-Country Data", 169 *Tax Notes Federal* 925 (9 November 2020), at 933*ff*, available at https://ssrn.com/abstract=3736287. Needless to say, Clausing's work was focused primarily on the United States. Many other countries, of course, are home to

pricing rules could be invoked by the countries in which these operations are conducted to increase the relevant service fees and other charges so that a more appropriate level of income is taxed in those countries.

Despite the obvious applicability of transfer pricing adjustments in many situations, such adjustments are difficult and time consuming for relevant tax authorities, especially in the case of developing countries. Transfer pricing tools, though, are not the only tools available to the countries where MNEs conduct the operations of their tax haven group members.[4] Other potentially easier-to-apply rules will often be available. Because these rules have seldom been used, it seems appropriate for the Committee to consider reviewing this area and deciding if guidance might be offered in the same manner as guidance has been provided in the area of transfer pricing. Some education in this area might provide significant results for many countries.

In short, there are two areas where local tax rules may provide tools that are easier to use than transfer pricing adjustments.

First, many countries define as resident taxpayers any entity that is managed and controlled locally. While in some cases such management and control may be viewed only formally through, for example, the location of board of directors' meetings, in other cases, there may be broader concepts that look to effective management or some more reality-based measure. Where this is the case, it may be factually easy to substantiate that a tax haven group member is being managed and controlled locally, thereby making it a local resident for tax purposes. Once a resident, then its income would be directly taxable under local rules.

Second, where a tax haven group member is not a tax resident under local rules, but its business is in fact being conducted by local personnel of a local group member, local tax rules as applied to non-residents may find that the tax haven group member has a local dependent agent permanent establishment. This of course would allow local direct taxation of the tax haven group member on its income attributable to that permanent establishment.

Education could be provided to countries on how to use CbC data to identify strong candidates for such local taxation as well as what questions to ask and what procedures to follow in the course of an audit so as to make and support relevant imposition of direct taxation on tax haven group members.

MNEs that have management and operating personnel located in regional and local offices around the world that conduct the businesses of their tax haven group members. See also Joe Hughes and Steve Wamhoff, "Why Congress Should Reform the Federal Corporate Income Tax", ITEP (17 September 2021), available at: https://itep.org/why-congress-should-reform-the-federal-corporate-income-tax/.

[4] Note that under Pillar Two and its home country-priority income inclusion rule, countries in which group personnel manage and conduct the business operations, the profits for which are recorded in tax haven group members, will not receive any of the tax on undertaxed profits, unless that country is the home country applying the IIR. Even if the undertaxed payment rule is able to be applied, there may not be applicable payments from such countries, meaning that there is no mechanism within Pillar Two to recoup taxable profits that rightly belong to such countries.

LISTING OF ARTICLES RELATED TO U.S. EFFECTIVELY CONNECTED INCOME RULES

1. Jeffery M. Kadet, “Attacking Profit Shifting: The Approach Everyone Forgets”, 148 Tax Notes 193 (13 July 2015), available at http://ssrn.com/abstract=2636073.

2. Thomas J. Kelley, David L. Koontz, and Jeffery Kadet, "Profit Shifting: Effectively Connected Income and Financial Statement Risks”, 221(2) Journal of Accountancy 48 (February 2016), available at http://ssrn.com/abstract=2728157.

3. Jeffery M. Kadet and David L. Koontz, “Profit-Shifting Structures and Unexpected Partnership Status”, 151 Tax Notes 335 (18 April 2016), available at http://ssrn.com/abstract=2773574.

4. Jeffery M. Kadet and David L. Koontz, “Profit-Shifting Structures: Making Ethical Judgments Objectively,” Part 1 at 151 Tax Notes 1831 (27 June 2016) and Part 2 at 152 Tax Notes 85 (4 July 2016), available at http://ssrn.com/abstract=2811267 and http://ssrn.com/abstract=2811280.

5. Jeffery M. Kadet and David L. Koontz, “Internet Platform Companies and Base Erosion--Issue and Solution,” Tax Notes, 4 December 2017, p. 1435, available at http://ssrn.com/abstract=3096925.

6. Jeffery M. Kadet and David L. Koontz, “Effects of New Sourcing Rule: ECI and Profit Shifting”, Tax Notes, 21 May 2018, p. 1119, available at http://ssrn.com/abstract=3201365.

7. Jeffery M. Kadet, “Sourcing Rule Change: Manufacturing and Competitiveness”, Tax Notes, 5 November 2018, p. 717, available at http://ssrn.com/abstract=3296763.

8. Jeffery M. Kadet and David L. Koontz, “Transitioning From GILTI to FDII? Foreign Branch Income Issues”, Tax Notes Federal, 1 July 2019, p. 57, available at http://ssrn.com/abstract=3428540.

9. Jeffery M. Kadet and David L. Koontz, “A Case Study: Effectively Connected Income”, Tax Notes Federal, 13 April 2020, p. 217, available at https://ssrn.com/abstract=3598733.