INTERNATIONAL TAX & THE EXTRACTIVE INDUSTRIES
– CHALLENGES OF PROFIT SHIFTING AND TRANSFER MISPRICING

INTERNATIONAL TAXATION: OPPORTUNITIES AND RISKS

April 17th, 2016
GENERAL CONTEXT

• Debate on optimal taxation of the sector
  ▪ Complex interaction between royalties, income taxes and other instruments
  ▪ Fiscal regimes vary in reliance on different instruments
  ▪ Profit based instruments are, at least theoretically superior, with fewer distortions, …
  ▪ … but may increase vulnerability to debt-shifting and transfer mispricing

• Income taxes often remain an important source of revenue
Common Profit Shifting Risks in Extractives

Areas of concern in extractives:

- Financing hubs
- Marketing hubs (under-charging for outbound supplies)
- HTVI and technical service fees
- Purchase of large capital goods (overpaying for inbound assets)
- Poorly conceived fiscal incentives risk exacerbating problems...
ANALYSIS OF PROFIT SHIFTING IN OIL AND GAS SECTOR

• O&G sector is special in frequently facing higher statutory income tax rates
  ➢ Increased profit shifting incentive & additional domestic dimension

SAMPLE COMPOSITION

- Firm level financial information from BvD’s ORBIS Database
  - Sample of 294 MNE parents and subsidiaries, 9 years of observations
  - 24% of the affiliates belong to MNE group with tax haven operations; 10% are majority owned by a national government
ANALYTICAL APPROACH

Beer/Loeprick (2015): Taxing Income in the Oil and Gas Sector- Challenges of Int. and Domestic Profit Shifting:

• Relationship between reported pre-tax profitability of affiliates and difference in intra-group tax rates
• Fixed effects regression explaining EBIT (P/L)
• Key explanatory variables: Foreign and domestic tax differentials of an affiliate with the rest of its MNE group
• Controls: value of fixed and other assets, employees, annual crude oil price
• We capture change in transaction specific shifting costs by interacting tax differentials with documentation requirements
FINDINGS

• Some support for concerns on profit-shifting in the sector
  ▪ Semi elasticity of EBIT w.r.t (sector specific) tax differentials in an MNE group of -1.68; Even higher when using EBT, allowing for debt shifting (-2.14)

• Indication of domestic profit shifting risks

• Consistent with earlier research (Fuest, Hebous, Riedel 2011) we observe higher vulnerability outside OECD

• We do not observe SOEs responding to tax differentials; Affiliates of MNEs operating in havens report less profit than their peers

• Finally, (in line with earlier work) we find mitigation effect of introducing documentation requirements
• Profit shifting is a critical concern for design of fiscal regimes
  • Risky domestic transaction need to be covered in TP legislation
• Benefits of strengthening domestic anti-abuse rules/transfer pricing documentation requirements
• Consideration of special measures:
  ▪ Deemed pricing, 6th Method
  ▪ Safe harbors/rebuttable presumptions as part of the solution?
  ▪ Reversal of the burden of proof to deal with information constraints/asymmetries
• Importance of DTA networks (“second line of defense”)
THANK YOU!