Johannesburg
PO Box 4056 | Cramerview 2060
Tel 011 884 0270 | **Fax** 011 884 5672
Email fmf@mweb.co.za

Cape Town
PO Box 805 | Cape Town 8000
Tel 082 941 5375
Email fmf.ct@mweb.co.za

Durban
PO Box 17156 | Congella 4013
Tel/Fax 031 572 3308
Email urbach@telkomsa.net

Submission to the Davis Tax Committee

Base Erosion and Profit Shifting (BEPS)

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Websites www.freemarketfoundation.com | www.healthpolicyunit.org
NPO No 020-056-NPO | PBO & Section 18A(1)(a) No 930-017-343

The Free Market Foundation

The Free Market Foundation (FMF) is an independent non-profit public benefit organisation founded in 1975 to promote and foster an open society, the rule of law, personal liberty, and economic and press freedom as fundamental components of its advocacy of human rights and democracy based on classical liberal principles. It is financed by membership subscriptions, donations and sponsorships.

Most of the work of the FMF is devoted to promoting economic freedom as the empirically best policy for bringing about economic growth, wealth creation, employment, poverty reduction and human welfare. As a think tank the FMFs fundamental approach to policy questions is consumer-based. Individual consumer choice is placed at the centre of any policy recommendations that the FMF espouses. Consumer satisfaction is generally achieved by an absence of barriers to entry into the provision of goods and services, allowing consumers a choice between the offerings of freely competing providers, and the absence of regulations that impose avoidable costly burdens on the providers of goods and services.

Introduction

The FMF welcomes the opportunity to provide input to the Davis Tax Committee (DTC) regarding the issue of base erosion and profit shifting (BEPS). According to the DTC, "The BEPS Sub-Committee is … aligned with the OECD BEPS Action Plan".[1] The OECD refers to BEPS as "Tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no corporate tax being paid".[2]

The departure point for the DTC hinges on how to minimise corporate tax avoidance by companies that have activities in more than one tax jurisdiction. Indeed, for many years a debate has raged on how 'unfair' it is that some multinational enterprises (MNEs) have found legal ways to reduce their tax burdens by running some of their operations through low-tax jurisdictions or so-called 'tax havens'. Although these practices are not illegal and the OECD has no idea to what extent BEPS occurs[3], it has taken it upon itself to provide solutions to tackle what it refers to as 'aggressive tax planning'. However, as the OECD BEPS Action Plan states, "Tax policy is at the core of countries' sovereignty, and each country has the right to design its tax system in the way it considers most appropriate". Moreover, the OECD notes, "Businesses cannot be faulted for using the rules that governments have put in place".[4]

The OECD explicitly argues for more international harmonisation of the corporate tax base to make it easier for countries to tax corporations worldwide. These calls should be rejected. Colluding to maintain corporate tax is neither necessary nor appropriate. The world continues to become more interconnected and countries will use their various comparative advantages to compete in order to attract MNEs. Rather than conspiring to adopt a one size-fits-all policy, the South African government should consider the option of switching to a better-designed and more simplified tax system.

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1 http://www.taxcom.org.za/docs/Davis%20Tax%20Committee%20Media%20Release%2020131105.pdf.

2 OECD: Centre for Tax Policy and Administration. BEPS – Frequently Asked Questions. Accessed: 23-01-2014. Available at: http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm.

3 See "How much tax revenue is lost to BEPS?" OECD: Centre for Tax Policy and Administration. BEPS – Frequently Asked Questions. Accessed: 23-01-2014. Available at: http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm.

4 OECD: Centre for Tax Policy and Administration. BEPS – Frequently Asked Questions. Accessed: 23-01-2014. Available at: http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm.

Critics of corporate tax cite many compelling reasons to justify the abolition of the tax. The principal rationale is that corporate taxes deter investment and constitute an additional tax on income that is ultimately borne by individuals. In simple terms, taxes may be levied on corporations but *ordinary people* pay taxes in their roles as employees, consumers and shareholders. Agreeing to internationally devised policies, with far reaching consequences, is the thin edge of the wedge for South African policy makers. South Africa must retain its sovereignty and be free to adopt policies that increase our global competitiveness and attractiveness as a viable investment destination if it is ever to enjoy in increased economic growth and provide opportunities that will enable all South Africans to prosper.

Tax competition between countries has caused global corporate tax rates to steadily decline (see Table 1: Global Corporate Tax rates, 2006-2013). Of the 130 tax jurisdictions analysed over the period, KPMG data reveals that 11 countries (8.5%) increased their corporate tax rates. In contrast, 61 tax jurisdictions lowered their corporate tax rates and 57 tax territories left their rates unchanged. The biggest hike occurred in Afghanistan, where the corporate tax rate was increased from 0% to the current 20% in 2007. Most countries that increased their taxes have applied only modest increases, whereas the majority of countries that lowered their tax rates implemented dramatic cuts. For example, Gibraltar and Qatar cut their corporate tax rates from 35% to 10%, whilst Kuwait slashed their corporate tax rate from 55% to 15%. Large reductions were also registered in Albania and Fiji where corporate tax rates were reduced from 20% to 10% and 31% to 20%, respectively. Of the countries where rates remained unchanged over the period, 11 tax jurisdictions already apply zero corporate tax rates.

On average, the global corporate tax rate declined from 27.5% to 24% over the sample period. North America has the highest average corporate tax rate at 33% (down from 38% in 2006) and Europe has the lowest average corporate tax rate at 21% (down from 24% in 2006). South Africa's corporate tax rate of 28% places it 1% below the continental average of 29%. The lowest African corporate tax rate is applied in Mauritius, where corporate tax rates have declined from 25% in 2006 to the current level of 15%. The important point to note is that, on average, in all regions across the globe, countries are systematically reducing their corporate tax rates. Various individual countries choose to reduce, or eliminate, the corporate tax for different reasons. It may be to increase the country's competitiveness but there is also a moral justification for reducing and ultimately eliminating the corporate tax.

Who pays corporate taxes?

There has been much debate about who pays corporate taxes. It should be clear that a corporation is only a legal means by which individuals do business. Taxes may be levied upon a corporation, but only *people* pay taxes in their roles as employees, consumers and shareholders. Most studies show that a part of corporate tax is passed on to workers in the form of lower wages and benefits.

Renowned economist, Laurence Kotlikoff, recently wrote in the New York Times (*Abolish the Corporate Income Tax*, Jan. 5, 2014), "I, like many economists, suspect that [America's] corporate income tax is economically self-defeating – hurting workers, not capitalists, and collecting precious little revenue to boot…It's been a long time since the typical American worker received a raise in her real pay. In fact, average weekly earnings, exclusive of fringe benefits but adjusted for inflation, are 10 percent lower today than they were in 1966…Turning things around requires getting a lot of things right, starting, I'd

argue, with corporate tax reform".[5] Kotlikoff concludes, "We need a tax system designed by economists, not politicians, so it will be simpler, fairer, more efficient, and will ensure our children's future".[6]

In an academic paper published by the National Bureau for Economic Research (NBER) the authors demonstrate why employees and not business owners stand to gain the most from *eliminating* corporate tax. Fehr et al (2013) state, "The reason is simple. Workers living in a country are generally immobile, i.e. they rarely seek employment abroad. On the other hand, capital that is invested domestically can be withdrawn and invested in other countries. When this capital flight occurs, the workers and their jobs are left behind, leading to lower labor demand and real wages for those able to retain their positions".[7] Thus, those who argue that corporations should pay taxes are implicitly arguing for lower wages – whether they know it or not.

Most large corporations listed on the Johannesburg Stock Exchange (JSE) are owned by ordinary people through their pension funds, including government and union-managed pension funds. When government and labour unions propose increasing corporate taxes, it is invariably a call for reduced pensions for civil servants and union members. Pension and mutual funds are merely collections of the savings of millions of middle and low-income individuals and high corporate tax rates serve to reduce the returns to these individuals' investments and life savings.

Corporate taxes also result in less money being available for companies to invest in research and development (R&D). Without this investment in R&D it would not be possible to expand business and hire more people. The OECD BEPS Action Plan claims that it seeks to stop "double taxation". It overlooks that money invested in corporate stocks has already been taxed at least once before when it was earned and will be taxed yet again when it is paid out in dividends or sold for a capital gain. This raises the question: How many times should the same income be taxed?

As Kotlikoff, along with many other economists, has demonstrated, the world would experience a better allocation of resources and more job creation if corporate income tax was abolished altogether. If this were to happen, disagreements over which jurisdiction gets to tax and how much it can tax would disappear, and the level and variation of complexity would be greatly diminished. This would result in a significant amount of resources being freed-up (both human and financial), and allow them to be allocated more efficiently elsewhere in the economy. Any purported revenue loss would be recovered through taxes incurred on the ensuing business activity and by the additional employment and purchasing power of ordinary citizens as a result of the termination of corporate tax.

The OECD BEPS Action Plan states, "…corporations that operate only in domestic markets, including family-owned businesses or new innovative companies, have difficulty competing with MNEs that have the ability to shift their profits across borders to avoid or reduce tax". Eliminating corporate tax would not only reduce, or eliminate, the incentive to shift profits abroad, but it would also eliminate all the time, effort and money that companies spend on 'tax avoidance'. The abolition of corporate tax would

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[5] Kotlikoff, L.J. (2014) *Abolish the Corporate Income Tax*, New York Times. Accessed 24 January 2014. Available at: http://www.nytimes.com/2014/01/06/opinion/abolish-the-corporate-income-tax.html?_r=1.

[6] Hillyer, Q. (2014) *Kill the Corporate Tax to Help Workers*, National Review Online. Accessed 24 January 2014. Available at: http://www.nationalreview.com/article/368240/kill-corporate-tax-help-workers-quin-hillyer.

[7] Fehr, H., Jokisch, S., Kambhampati, A. and L.J. Kotlikoff (2013) Simulating the Elimination of the U.S. Corporate Income Tax. Accessed 24 January 2014. Available at: http://www.kotlikoff.net/sites/default/files/Corporate%20Income%20Tax%20NBER%20WP%2019757.pdf.

level the playing field for smaller businesses that typically cannot afford to hire lawyers and accountants to devise tax-avoidance strategies, which currently give MNEs a potential competitive advantage.

Conclusion

Reducing or eliminating corporate tax would curtail numerous wasteful tax distortions, boost economic growth, increase South Africa's competitiveness and attractiveness as an investment destination and raise future wages. Future wages are adversely affected by high corporate tax rates because corporate taxes retard capital formation and decrease the overall level of investment, which negatively impacts on future labour productivity and wages. The abolition of corporate tax would also negate any debate regarding who pays the tax and where it should be levied and collected.

Annex

Table1: Global Corporate Tax rates, 2006-2013

Location	2006	2007	2008	2009	2010	2011	2012	2013	% Change (2006-2013)*
Afghanistan	0	20	20	20	20	20	20	20	20%
Albania	20	20	10	10	10	10	10	10	-50%
Angola	35	35	35	35	35	35	35	35	0%
Argentina	35	35	35	35	35	35	35	35	0%
Armenia	20	20	20	20	20	20	20	20	0%
Aruba	35	28	28	28	28	28	28	28	-20%
Australia	30	30	30	30	30	30	30	30	0%
Austria	25	25	25	25	25	25	25	25	0%
Bahamas	0	0	0	0	0	0	0	0	0%
Bahrain	0	0	0	0	0	0	0	0	0%
Bangladesh	30	30	30	27.5	27.5	27.5	27.5	27.5	-8%
Barbados	25	25	25	25	25	25	25	25	0%
Belarus	24	24	24	24	24	24	18	18	-25%
Belgium	33.99	33.99	33.99	33.99	33.99	33.99	33.99	33.99	0%
Bermuda	0	0	0	0	0	0	0	0	0%
Bolivia					25		25	25	0%
Bonaire							0	0	0%
Bosnia and Herzegovina	10	10	10	10	10	10	10	10	0%
Botswana	25	25	25	25	25	22	22	22	-12%
Brazil	34	34	34	34	34	34	34	34	0%
Bulgaria	15	10	10	10	10	10	10	10	-33%
Cambodia					20	20	20	20	0%
Canada	36.1	36.1	33.5	33	31	28	26	26	-28%
Cayman Islands	0	0	0	0	0	0	0	0	0%
Chile	17	17	17	17	17	20	18.5	20	18%
China	33	33	25	25	25	25	25	25	-24%
Colombia	35	34	33	33	33	33	33	25	-29%
Costa Rica	30	30	30	30	30	30	30	30	0%
Croatia	20	20	20	20	20	20	20	20	0%
Curacao						34.5	27.5	27.5	-20%
Cyprus	10	10	10	10	10	10	10	12.5	25%
Czech Republic	24	24	21	20	19	19	19	19	-21%
Denmark	28	25	25	25	25	25	25	25	-11%
Dominican Republic	30	25	25	25	25	29	29	29	-3%
Ecuador	25	25	25	25	25	24	23	22	-12%
Egypt	20	20	20	20	20	20	25	25	25%
El Salvador							30	30	0%
Estonia	23	22	21	21	21	21	21	21	-9%
Fiji	31	31	31	29	28	28	28	20	-35%
Finland	26	26	26	26	26	26	24.5	24.5	-6%
France	33.33	33.33	33.33	33.33	33.33	33.33	33.33	33.33	0%
Georgia								15	N/A
Germany	38.34	38.36	29.51	29.44	29.41	29.37	29.48	29.55	-23%
Gibraltar	35	35	33	27	22	10	10	10	-71%

Greece	29	25	25	25	24	20	20	26	-10%
Guatemala	31	31	31	31	31	31	31	31	0%
Guernsey	0	0	0	0	0	0	0	0	0%
Honduras	30	30	30	30	25	35	35	35	17%
Hong Kong	17.5	17.5	16.5	16.5	16.5	16.5	16.5	16.5	-6%
Hungary	16	16	16	16	19	19	19	19	19%
Iceland	18	18	15	15	18	20	20	20	11%
India	33.66	33.99	33.99	33.99	33.99	32.44	32.45	33.99	1%
Indonesia	30	30	30	28	25	25	25	25	-17%
Ireland	12.5	12.5	12.5	12.5	12.5	12.5	12.5	12.5	0%
Isle of Man	0	0	0	0	0	0	0	0	0%
Israel	31	29	27	26	25	24	25	25	-19%
Italy	37.25	37.25	31.4	31.4	31.4	31.4	31.4	31.4	-16%
Jamaica	33.33	33.33	33.33	33.33	33.33	33.33	33.33	25	-25%
Japan	40.69	40.69	40.69	40.69	40.69	40.69	38.01	38.01	-7%
Jersey	0	0	0	0	0	0	0	0	0%
Jordan	25	25	25	25	14	14	14	14	-44%
Kazakhstan	30	30	30	20	20	20	20	20	-33%
Kenya							30	30	0%
Korea, Republic of	27.5	27.5	27.5	24.2	24.2	22	24.2	24.2	-12%
Kuwait	55	55	55	15	15	15	15	15	-73%
Latvia	15	15	15	15	15	15	15	15	0%
Libya		40	40	40	40	20	20	20	-50%
Liechtenstein						12.5	12.5	12.5	0%
Lithuania	15	15	15	20	15	15	15	15	0%
Luxembourg	29.63	29.63	29.63	28.59	28.59	28.8	28.8	29.22	-1%
Macau	12	12	12	12	12	12	12	12	0%
Macedonia	15	12	10	10	10	10	10	10	-33%
Malawi							30	30	0%
Malaysia	28	27	26	25	25	25	25	25	-11%
Malta	35	35	35	35	35	35	35	35	0%
Mauritius	25	22.5	15	15	15	15	15	15	-40%
Mexico	29	28	28	28	30	30	30	30	3%
Montenegro	9	9	9	9	9	9	9	9	0%
Mozambique	32	32	32	32	32	32	32	32	0%
Namibia						34	34	33	-3%
Netherlands	29.6	25.5	25.5	25.5	25.5	25	25	25	-16%
New Zealand	33	33	30	30	30	28	28	28	-15%
Nigeria	30	30	30	30	30	30	30	30	0%
Norway	28	28	28	28	28	28	28	28	0%
Oman	12	12	12	12	12	12	12	12	0%
Pakistan	35	35	35	35	35	35	35	35	0%
Panama	30	30	30	30	27.5	25	25	25	-17%
Papua New Guinea	30	30	30	30	30	30	30	30	0%
Paraguay	10	10	10	10	10	10	10	10	0%
Peru	30	30	30	30	30	30	30	30	0%
Philippines	35	35	35	30	30	30	30	30	-14%
Poland	19	19	19	19	19	19	19	19	0%
Portugal	27.5	25	25	25	25	25	25	25	-9%
Qatar	35	35	35	35	10	10	10	10	-71%

Romania	16	16	16	16	16	16	16	16	0%
Russia	24	24	24	20	20	20	20	20	-17%
Saba							0	0	0%
Samoa	29	27	27	27	27	27	27	27	-7%
Saudi Arabia	20	20	20	20	20	20	20	20	0%
Serbia	10	10	10	10	10	10	10	15	50%
Singapore	20	20	18	18	17	17	17	17	-15%
Slovak Republic	19	19	19	19	19	19	19	23	21%
Slovenia	25	23	22	21	20	20	18	17	-32%
South Africa	**36.89**	**36.89**	**34.55**	**34.55**	**34.55**	**34.55**	**34.55**	**28**	-24%
Spain	35	32.5	30	30	30	30	30	30	-14%
Sri Lanka	32.5	35	35	35	35	28	28	28	-14%
St Eustatius							0	0	0%
St Maarten						34.5	34.5	34.5	0%
Sudan	35	30	15	15	15	35	35	35	0%
Sweden	28	28	28	26.3	26.3	26.3	26.3	22	-21%
Switzerland	21.23	20.63	19.21	18.96	18.75	18.31	18.06	18.01	-15%
Syria	35	28	28	28	28	28	28	22	-37%
Taiwan	25	25	25	25	17	17	17	17	-32%
Tanzania				30	30	30	30	30	0%
Thailand	30	30	30	30	30	30	23	20	-33%
Trinidad and Tobago							25	25	0%
Tunisia	35	30	30	30	30	30	30	30	-14%
Turkey	20	20	20	20	20	20	20	20	0%
Uganda	30	30	30	30	30	30	30	30	0%
Ukraine	25	25	25	25	25	25	21	19	-24%
United Arab Emirates	55	55	55	55	55	55	55	55	0%
United Kingdom	30	30	30	28	28	26	24	23	-23%
United States	40	40	40	40	40	40	40	40	0%
Uruguay	30	30	25	25	25	25	25	25	-17%
Vanuatu	0	0	0	0	0	0	0	0	0%
Venezuela	34	34	34	34	34	34	34	34	0%
Vietnam	28	28	28	25	25	25	25	25	-11%
Yemen	35	35	35	35	35	20	20	20	-43%
Zambia	35	35	35	35	35	35	35	35	0%
Zimbabwe	30.9	30.9	30.9	30.9	25.75	25.75	25.75	25.75	-17%
Regional Averages	**2006**	**2007**	**2008**	**2009**	**2010**	**2011**	**2012**	**2013**	**% Change**
Africa average	31	31	29	29	28	29	29	29	**-7%**
North America average	38	38	37	37	36	34	33	33	**-13%**
Asia average	29	28	28	26	24	23	23	22	**-22%**
Europe average	24	23	22	22	21	21	20	21	**-13%**
Latin America average	29	28	28	28	28	29	28	28	**-5%**
Oceania average	31	30	30	29	29	29	29	27	**-12%**
EU average	25	24	23	23	23	23	23	23	**-9%**
OECD average	28	27	26	26	26	25	25	25	**-8%**
Global average	28	27	26	25	25	25	24	24	**-12%**

Source: KPMG (Accessed 23-01-2014) and authors own calculations. Available at: *http://www.kpmg.com/Global/en/services/Tax/tax-tools-and-resources/Pages/corporate-tax-rates-table.aspx*
**The percentage change was calculated using 2006 as the base year or the next available year*

Prepared by
Jasson Urbach, Director, Free Market Foundation