The rise of tax nationalism

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Traditionally, international tax gurus possess skills on core topics such as residence and source, and to more complex concepts such as permanent establishments and transfer pricing. Tax treaties are diligently studied. And since 2012, they've been following the OECD's Base Erosion and Profit Shifting (BEPs) project – a global collaborative effort to address tax gaps and mismatches.

Increasingly however, CAs practicing in this field must also monitor the rise of tax nationalism, a subset of economic nationalism. Here, there are no textbooks, no rules. Just a bewildering mix of good cop, bad cop tax policies.

Unilateralism v's the OECD's multilateral approach

I'm not just talking about President Trump's tax reform plans, but let's deal with the USA first.

The USA did not sign the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (known as the Multilateral Instrument or "MLI") in June 2017.

That's a worry given the central role our great and powerful friend plays in global economic activity. But the possible tax ramifications are unclear, overshadowed here by bigger stories such as the cancellation of US participation in the Trans-Pacific Partnership.

However, the surprising speed with which Congress is dealing with the Tax Cuts and Jobs Bill means tax policy could soon attract the world's full attention.

How does the US play the good cop, bad cop game?

Well, the bad cop appears in the Bill before Congress, in a range of anti-abuse rules which (for example) impose interest deduction restrictions and an "excise tax" on certain payments from US companies to related foreign companies.

The good cop entices America's global businesses to bring home foreign earnings at a one-time low rate, and the Bill also establishes an on-going participation exemption system for foreign income.

Now if these reforms are enacted and US multinationals start routinely repatriating foreign earnings, I reckon the Americans won't take kindly to other countries attacking their multinationals. There could potentially be more three-way disputes involving taxpayers, tax regulators such as the ATO, and the IRS. That's quite different from a tax stoush with Bermuda.

The obvious question? Will Trumpism derail BEPs and impact IRS' thinking on multijurisdictional tax dispute resolution.

But President Trump isn't alone in using the tax system for the sole purpose of advancing his country's interests.

Over in the United Kingdom, the Chancellor of the Exchequer has recently doubled-down on the Diverted Profits Tax with *another* unilateral tax law with extra territorial reach – a new withholding tax on royalties paid to low-tax jurisdictions relating to UK sales.

Australia has already followed the UK with its own DPT and the related Multinational Anti-Avoidance Law or "MAAL", both buried inside our General Anti-avoidance Rule provision ("Part IVA") and thus immune from our tax treaty obligations, including the scope of the mutual agreement procedure for resolving cross-border tax disputes.

The digital economy

But nowhere is tax nationalism more apparent than in the digital economy. For example:

- India has imposed a 6% equalization levy (withholding) on business-to-business payments to a non-resident service provider for specified digital services

- France, Germany, Italy and Spain have recently called for tax to be paid on revenues (not profits), and their proposal has been backed by Romania, Bulgaria, Slovenia, Greece, Portugal and Austria.

Less developed nations – already suspicions that BEPs is really a rich nation initiative to carve-up the global income tax pie amongst themselves – are likely to pile onto similar taxes on digital revenue streams.

At a time of rapid technological change, the (tax) world will be split between old and new policy thinking.

Economically, the "old" perspective is that such unilateral tax measures increase supply costs to those markets and potentially adversely impact economic development and consumers. The "new" thinking is that our appetite for all things online is making demand for digital products and services inelastic, and taxing revenue streams is simple and effective.

In an "old" tax context, cut-through turnover taxes overturn decades of transfer pricing work, particularly involving the exploitation of intangibles, and the accepted methods for compensating others in a multinational group for functions performed, assets used, and risks assumed.

Transfer pricing models are complex and broken say the "new" thinkers.

But both camps would agree in one important respect: unlike income taxes which generally trigger foreign tax credit entitlements, countries which embrace new turnover-type taxes can create double taxation scenarios outside the current purview of tax treaties.

Treaties need to catch-up, fast.

To date, Australia's approach to the digital economy has been to impose GST on digital services (the so-called "Netflix Tax") – a model favoured by the OECD. New Zealand, South Africa and Japan have done likewise.

Should Australia follow the unilateral, nationalist new thinking and tax the *revenue streams* of tech companies?

I'd be surprised if someone in Treasury hasn't written a briefing paper on the pros and cons.

BREXIT

Tax nationalism is also a huge issue for BREXIT watchers but here the impost most mentioned is old-fashioned customs duty.

Once the UK and Europe strike a deal on the divorce payment, there is hope that new customs barriers can be ameliorated by allowing Britain to become part of the European Free Trade Association.

There is also a looming post-BREXIT tax war to retain and attract financial services activity, with Londoners hoping the promise of a "17% by 2020" (good cop) UK company tax rate will help safeguard the City and make it the Singapore of the North.

Unilateral approaches cut both ways

In an environment where many Australians are convinced large companies – and multinationals in particular – could and should pay more tax, it's hard to find any political leader publicly questioning whether we've been a bit too much of a bad cop on big business.

The Prime Minister and Treasurer have pitched hard the need for a 25% large company tax rate, but in Canberra the word is that this has zero chance of getting up.

Yet there are no shortage of supporters for free trade and foreign investment. Perhaps these MPs and their advisers simply don't see any connection with tax policy as they travel abroad on their trade missions.

Indeed, it's quite possible Australia will soon take more bad cop unilateral tax action against big business. The Coalition has been an admirer of recent UK international anti-avoidance tax measures, and the Australian Labor Party has said it will, if elected, further restrict interest deductions by introducing a worldwide gearing ratio.

But as Einstein observed, politics is a pendulum, particularly if Australians see countries in our region prospering in competing areas of modern economic activity (e.g. services, technology).

Millennials in particular might develop a greater appreciation of how value is created in digitalised business models and question policy settings which discourage such activity here.

Who knows?

Australians might one day start challenging Treasury Ministers and the ATO about whether our tax policies and administrative practices actually *boost* the jobs and growth that can only come from a prosperous, globally competitive Australia Inc.