ECON JOURNAL WATCH 14(1)
January 2017: 77–102

"Stop This Greed": The Tax-Avoidance Political Campaign in the OECD and Australia

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LINK TO ABSTRACT

In 2014 Australia held the rotating presidency of the G20, hosting the meeting of the finance ministers and central bank governors and the meeting of the G20 leaders. Both meetings saw the G20 nations endorse the Base Erosion and Profit Shifting (BEPS) Action Plan. The BEPS Action Plan had been prepared by the OECD a year earlier as a "co-ordinated and comprehensive" response to the possibilities posed by globalization for tax avoidance by multinational firms (OECD 2013a). For its part, the Australian government announced in its federal budget in May 2015 that it was going to introduce legislation to "ensure foreign and multinational companies pay their share of tax." The *Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015* received royal assent in December 2015.

This paper is a critique of the political claims which have accompanied the debate about multinational tax avoidance, both at the OECD and within Australia. The movement within Australia provides an example of domestic policymakers adapting arguments pushed by international bodies to fit local political agendas. Australia provides a useful example for two reasons. First, Australia's leaders used its presidency of the G20 to drive a domestic agenda on corporate tax avoidance. Second, it has a relatively high reliance on corporate tax revenue as a part of its total tax take (18 percent in 2013, compared to an unweighted OECD average of 8.4

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percent, and ranking in the OECD second only to Norway, which like Australia is rich in natural resources).

Multinational firms conduct commerce across national boundaries, transfer resources between affiliates across those boundaries, and exercise ownership and control over their affiliates. Another feature of multinational firms is a cosmopolitan outlook. Their choice of location is not much constrained by questions of patriotism or cultural identity. They are more or less indifferent as to the jurisdiction in which they invest, "except as determined by expected profitability, risk, or any other objective standard derived from [the] pecuniary goal" (Kopits 1976b, 627).

We describe the practices where corporate or individual taxpayers move income offshore in order to reduce their domestic tax profile as tax *avoidance*, rather than the more pejorative and loaded term tax *evasion*. This distinction is not controversial. It is true that the Australian Taxation Office has attempted to blur the distinction between avoidance and evasion (see Seldon 1979 for a discussion of tax "avoision"). Nevertheless, Australian parliamentary debate reflects the same distinction as we adopt here. As the chair of the Senate Economics References Committee, Sam Dastyari, stated in 2015, "Tax avoidance is questionably moral behaviour. It is legal. Tax evasion is illegal behaviour. I think they are the two terms."[3]

The prehistory of the OECD's "Harmful Tax Competition" and BEPS projects mixes concerns about lawful tax avoidance with concerns about illegal tax evasion and money laundering. In our assessment, popular commentary on these issues, too, rarely distinguishes between tax planning practices which are legal but (judged to be) unfair or unethical, and those which are illegal under domestic tax law.

The 1981 Gordon Report

Political interest in tax havens during the 1970s led the Carter administration in the United States to commission the 1981 Gordon Report, which formulated three key attributes that would positively identify a country as a tax haven: (1) low or no tax on income from foreign sources or certain types of business, (2) common-law or statutory secrecy provisions that were not relaxed in the case of a serious violation of the laws of another country, and (3) a relatively high importance of banking to the economy. The Gordon Report recommended that the United States terminate its tax treaties with known tax havens such as the Netherlands Antilles,

3. Official Committee Hansard, Senate Economics References Committee, April 8, 2015, p. 6 (**link**).

increase information requirements on U.S. taxpayers concerning their international transactions, seek stronger information exchange from foreign jurisdictions, and dissuade firms from doing business in jurisdictions which maintained secrecy laws (Gordon 1981).

The United States did not immediately adopt the recommendations of the Gordon Report. That slow progress led to an increased political salience of both the existence of tax havens and aggressive tax-planning practices. By the mid-1990s international agencies such as the International Monetary Fund were warning that mobile capital meant the residency principle for levying corporate and personal income taxes would only be sustainable if there was transparent information transfer between tax authorities (Eccleston 2012). Since the 1990s, the Organization for Economic Cooperation and Development (OECD) has chiefly driven international efforts on tax avoidance; the OECD has taken the function of an "informal 'world tax organization'" (Cockfield 2006). The OECD's efforts on tax avoidance can be divided into two waves. The first was fashioned as the Harmful Tax Competition (HTC) project. After the perceived failure of that project, a second effort, from 2013, was fashioned as a move against Base Erosion and Profit Shifting (BEPS). We treat each in turn.

The OECD's "Harmful Tax Competition" project

In May 1996, a communique from the G7 summit in Lyon declared that "Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases" and requested the OECD "vigorously pursue its work in this field" with the aim to establish multilateral action on reducing such competition. The OECD published its report *Harmful Tax Competition: An Emerging Issue* in 1998. This report propounded the notion that tax competition could be harmful, and it proposed to list OECD member and non-member countries with preferential tax regimes alongside its listed "tax havens."

What constituted harmful tax competition? In its treatment, the report distinguished between the positive aspects of tax competition—globalization putting pressure on national tax systems to modernize and reduce tax barriers to capital flows—and what it saw as negative or harmful aspects—the opportunity that globalization has offered firms to "minimise and avoid taxes" and individual countries to "enact tax policies aimed primarily at diverting financial and other

geographically mobile capital" (OECD 1998, 14). In this sense the incidence of *harm* in harmful tax competition is placed on domestic tax systems. The report states:

> … these schemes can erode national tax bases of other countries, may alter the structure of taxation (by shifting part of the tax burden from mobile to relatively immobile factors and from income to consumption) and may hamper the application of progressive tax rates and the achievement of redistributive goals. (OECD 1998, 14)

This distinction between positive and harmful tax competition is deeply ambiguous. The consequences outlined above—the erosion of a national tax base, changing structures of taxation, and the hampering of progressive tax rates and redistributive goals—are caused by all forms of tax competition, not only "harmful" competition. Rather than outline the characteristics of harmful competition, the OECD report instead identified the characteristics of tax havens and preferential tax regimes that it sought to tackle through multilateral action. The places against which it pushed for action were described as places where there are: zero or only nominal taxes, a lack of information exchange, a lack of transparency, ring-fencing of tax regimes to prevent residents from accessing the preferential regime or to prevent beneficiaries from accessing domestic markets (in the case of preferential tax regimes), and no substantial economic activities (in the case of tax havens). The report described these as features of "harmful tax competition" based on its own judgment that the apparently negative aspects outweigh the positive aspects. There were no empirical bases for these claims; indeed, the report noted that "The available data do not permit a detailed comparative analysis of the economic and revenue effects involving low-tax jurisdictions" (ibid., 17).

The 1998 report offered definitions of harmful competition that could be best described as casual: "redirect[ing] capital and financial flows and the corresponding revenue…by bidding aggressively for the tax base of other countries," or when "the spillover effects of particular tax practices are so substantial that they are concluded to be poaching other countries' tax bases" (OECD 1998, 16). At a certain level of abstraction, all competition involves "bidding"—sometimes "aggressively"—for business, and the word "poaching" is used regularly to describe events that occur in competitive markets. The existence of aggressive competition is not a black mark against competition. It is possible that tax havens and preferential tax regimes lead to suboptimal flows of capital, but this is not shown by declaring that competition between national tax regimes is "harmful." Later in this paper we explore the economic function of international tax competition.

The OECD/G20 "Base Erosion and Profit Shifting" (BEPS) project

Having found support from a coincidence of center-left governments in major world economies in the mid-1990s, the HTC project floundered when the incoming Bush administration made it clear that the project was not in line with its priorities (Eccleston 2012; Palan et al. 2010). OECD work on tax avoidance was only revived after the 2008 Global Financial Crisis. At its second meeting in 2009, the newly constituted Group of 20 countries declared an intention to "take action against non-cooperative jurisdictions, including tax havens. We stand ready to deploy sanctions to protect our public finances and financial systems. The era of banking secrecy is over" (G20, 2009). In this way the G20 connected, at least rhetorically, the ongoing financial crisis with a crackdown down on tax competition. The OECD entered a "symbiotic relationship" (Eccleston 2012, 87) with the G20, which was trying hastily to develop an international reform agenda. The G20 structure gave the project greater authority than the OECD could provide (Kudrle 2014). In this period, the OECD and G20 greatly expanded the Global Forum on Transparency and Exchange of Information for Tax Purposes, which had been first established in 2000 to enact recommendations from the HTC project with 32 members. The Global Forum now has 130 members.

The June 2012 G20 leaders meeting directed the OECD's tax avoidance work to be refashioned in terms of "base erosion and profit shifting," and in February 2013 the OECD published *Addressing Base Erosion and Profit Shifting* (OECD 2013b). The report was followed in July 2013 by the *Action Plan on Base Erosion and Profit Shifting* (OECD 2013a). The BEPS project focused on the "erosion" of the tax revenue base from firms shifting profits across borders in a way that might cause double non-taxation. Here the emphasis narrowed to the "integrity of the corporate income tax," rather than personal-and-corporate income taxes (2013b, 8). The BEPS project shifted political attention away from the HTC projects' bellicose rhetoric about tax havens to preferential regimes, "mismatches" between domestic tax regimes that might allow firms to avoid tax liabilities, the treatment of transfer pricing and thin capitalization rules, the taxation of digital goods, and "aggressive tax planning" (ibid., 6).

The BEPS project makes two basic claims. The first is that the corporate income tax base is being eroded. The second is that the cause of that base erosion is firms shifting profits across borders. The initial BEPS paper was careful, however, not to overstate the significance of these claims. The report addressed itself to the

"growing perception" that governments are being denied legitimate revenue from corporate tax planning, noting claims in major newspapers about tax avoidance and misleading, "simplistic" arguments by non-government organizations about the nature of corporate taxation (ibid., 13). The OECD admitted that given the relatively small proportion of corporate tax as a percentage of total tax take, "the scale of revenue losses through BEPS may not be extremely large." Furthermore, "it is difficult to reach solid conclusions about how much BEPS actually occurs" (15). However, the OECD argued that BEPS may still be significant "in monetary terms" and may be of more proportional interest due to its "effects on the perceived integrity of the tax system," i.e., that BEPS may undermine tax morale (ibid.). The paper looked at the possible mechanisms by which BEPS might occur—principally mismatches between domestic tax regimes—rather than demonstrating that this was a materially significant tax revenue issue.

In this context, it is important to emphasize what BEPS is not. It is not about making use of bank secrecy to conceal profits, and it is not simply a case of transfer pricing. BEPS is alleged to be making use of those legal provisions to avoid double taxation to ensure the non-taxation of profit. While superficially similar to transfer pricing issues, BEPS is a distinct phenomenon and deserves to be treated as such (Kleinbard 2011a; b). The irony is that multinational corporations could be fully compliant with the letter of domestic tax law and international treaties, and still be 'guilty' of wrongdoing under the arguments being made to justify the BEPS program.

BEPS in Australia

Since the global financial crisis, the Australian federal government has run a sustained budget deficit, largely to cover recurrent expenditure (Makin and Pearce 2016). This deficit has played a large role in Australian politics, as both sides of politics have proposed and sought to implement measures to reduce this deficit. Under the Labor government (2007–2013), the Treasurer Wayne Swan had been concerned with "vested interests" who fought against proposed tax impositions on mining and carbon dioxide emissions (Swan 2012; 2014). Driven by media attention on technology companies like Google, Apple, and eBay (Butler and Wilkins 2012), the political focus narrowed during 2012 and 2013 to corporate tax avoidance.

Of particular significance was a report published by Tax Justice Network Australia in 2014 that reported that effective tax rates calculated from annual financial statements substantially deviated from Australia's (then) statutory company tax rate of 30 percent. What was not reported, however, is the fact that every

public company has a tax reconciliation note in its annual financial statements. There is no mystery to the "book-tax income gap," either at a company level or from a policy perspective (see Davidson 2014b; 2015a). While the report was severely criticized (see, e.g., McCrann 2014), nonetheless it established in the public mind the *notion* of widespread wrongdoing on the part of business and led to a Parliamentary inquiry into corporate tax avoidance—we discuss this inquiry below.

Australian policymakers were also responsive to developments in the OECD and the G20. OECD work in 2010 on transfer pricing reform led to legislative changes in 2012 ensuring that Australian transfer pricing rules were interpreted according to OECD guidelines.[4] Changes to Australia's general anti-avoidance rule, foreshadowed since March 2012, were introduced into parliament the day after the release of the OECD's BEPS report in March 2013.[5] Two papers on the taxation of multinational enterprises by the Treasury department in May and July 2013 followed, presaging further reform (Treasury 2013a; c). The election of the conservative Abbott government at the end of 2013 coincided with Australia's presidency of the G20, and the new government publicly aligned itself with the intention behind the OECD/G20 program (Abbott 2013; Hockey 2013). Changes to thin capitalization laws were announced in November 2013 and passed in September 2014.[6]

The changes to Australian tax rules were accompanied by reforms to the conditions for 'disclosure' of corporate tax information—*disclosure* used in this manner means the *government* making public tax information about individual corporations, not those corporations disclosing information about themselves. In February 2013, the Labor government announced that "recent events in Australia and around the world call into question whether large and multinational businesses should have the same level of confidentiality about the taxes they have paid" and that "Large multinational companies that use complex arrangements and contrived corporate structures to avoid paying their fair share of tax should not be able to hide behind a veil of secrecy" (Bradbury 2013a). A Treasury paper two months later argued that Australia's "voluntary compliance" tax system required public confidence in the fairness of that system. Perceptions of unfairness might lead to "heightened efforts to avoid tax" (Treasury 2013b, 7). Such efforts would require more intrusive compliance controls, which could also in turn undermine confidence and the tax system's sustainability.

To counter the perception of unfairness, the Treasury proposed that the Commissioner of Taxation be required to disclose to the public limited tax return

4. Tax Laws Amendment (Cross-Border Transfer Pricing) Bill (No. 1) 2012.
5. Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Bill 2013.
6. Tax and Superannuation Laws Amendment (2014 Measures No. 4) Bill 2014.

information for companies whose total income is AU$100 million or more, as well as any minerals resource rent tax or petroleum resource rent tax payable. The information required was the business number and name, reported total income, taxable income, and corporate income tax payable. For publicly listed companies, this information is already available in annual financial statements, as is a tax reconciliation between financial accounting and tax accounting. Legislation was introduced into parliament to give effect to this proposal in May 2013 and passed in June.[7] In the second half of 2015 the Coalition government modified the threshold to distinguish between publicly listed and foreign-owned companies, who were subject to disclosure if their total income was above $100 million, and private companies, who were subject to disclosure only if their total income was above $200 million.[8] As the Australian Taxation Office (2013) noted, the purpose of disclosure reforms was to "discourage" aggressive tax planning and "encourage public debate about corporate tax policy." Tax disclosure, however, was not a requirement or recommendation of the G20/OECD process. Indeed, the director of the OECD's Centre for Tax Policy and Administration, Pascal Saint-Amans, argued that disclosure "may be misleading and it could do big damage unfairly" (quoted in Khadem 2014). It has been suggested that this disclosure constitutes a 'market mechanism' promoting greater tax compliance. Market mechanisms, however, usually work to reduce information asymmetry. In fact, for publicly listed companies, all the information being 'disclosed' is already publicly available. It is not clear that re-releasing public information and exposing it to a less well-informed audience than the Australian Tax Office could reduce asymmetric information and encourage greater tax compliance.

Public shaming as a revenue strategy

While in opposition the Coalition parties evinced some skepticism about the Labor government's crackdown on corporate tax avoidance, particularly the disclosure reforms. The Coalition won government in 2013. Their period in government coincided with increasing public discussion about corporate tax avoidance. A keyword search of five major Australian newspapers finds over 800 articles referring to corporate tax avoidance between 2013 and 2015, most coming in the third year.[9] The establishment of a Senate committee inquiry into Corporate

7. Tax Laws Amendment (2013 Measures No. 2) Bill 2013.
8. Tax and Superannuation Laws Amendment (Better Targeting the Income Tax Transparency Laws) Bill 2015; Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2015.
9. Based on a Factiva search for *"corporate tax" and avoidance*, in *The Age*, *The Sydney Morning Herald*, *The Australian Financial Review*, *The Australian*, and the *Canberra Times*.

Tax Avoidance in October 2014 ensured a steady drip throughout the next year of newspaper reports on tax planning practices among large firms. The inquiry took testimony from more than a dozen technology, mining, and pharmaceutical firms, as well as various non-profit organizations which had campaigned on corporate tax avoidance such as the Uniting Church, the Australia Institute (a progressive think tank), and unions such as United Voice and the Community and Public Sector Union. As one commentator wrote, this inquiry gave a number of Senators the opportunity to "berate local leaders of the world's biggest technology companies" in front of the press (Treadgold 2015).

The committee's first report, released in August 2015, emphasized that the Australian taxation system was "strong and, in many respects, world leading," but noted that a number of multinational companies which derived significant revenue in Australia yet paid little to no corporate tax. The title of that report, *You Cannot Tax What You Cannot See*, characterized the recommendations, which were concerned both with the information sharing efforts driven through the G20/OECD BEPS project, as well as further recommendations for domestic disclosure, including: (1) a mandatory tax reporting code for large Australian and multinational companies operating in Australia, (2) a public register of tax avoidance settlements, (3) an annual report of tax minimization and avoidance include estimates of revenue foregone, (4) an annual report of tax avoidance compliance activities, (5) the publication of country-by-country reports, and (6) a requirement that government tender bids state a firm's country of domicile for tax purposes (Senate Economics References Committee 2015). Should these recommendations be adopted in whole or in part, they would be certain to guarantee the same drip-feed of press reports that had accompanied the inquiry itself. The emphasis placed on public disclosure suggests a limited range of possible public responses and the committee's apparent view that tax avoidance is an issue best addressed through public suasion rather than reform to the tax code.

It is worth exploring this notion in a bit more detail. The problem policy-makers face in conceptualizing BEPS is that companies in general and multinationals in particular are generally compliant with domestic tax law. BEPS does not suggest that companies are not paying their legally mandated tax liabilities, but rather that they should be paying more. So it appears that the Senate committee was hoping that companies would 'agree' to pay more tax than they are legally mandated to pay through a process of public shaming. Yet paying money to (foreign) governments in the absence of a clear tax liability or court order is likely to violate norms—if not actual laws—against paying bribes. Soliciting such payments from multinational corporations is also problematic for a country that purports to operate under the rule of law. If the Australian government wishes to raise more revenue from taxation it should pass an appropriate law through the parliament or

enforce the existing laws it has previously passed through the parliament, though there may be little scope to increase company tax revenue through more rigorous enforcement of existing laws (Davidson and Heaney 2012).

The committee was unable to come to a conclusion about how significant corporate tax minimization and avoidance was in the Australian context. The lack of conclusion was a reflection of the evidence put to the committee. Treasury officials appearing in front of the committee were asked directly about how much revenue was being lost to multinational tax avoidance. In response, the Deputy Secretary answered that they "really do not know."[10] We address this issue below.

The Coalition government made countering multinational tax avoidance one of the central revenue features of its 2015–16 budget.[11] The government released draft tax legislation intended to "stop multinational entities using artificial or contrived arrangements to avoid a taxable presence in Australia."[12] This legislation, which was introduced to parliament in September, lowered the threshold under which the Australian Tax Office (ATO) could make a claim under the general anti-avoidance law, increased penalties for tax avoidance, and enabled the ATO to judge that profit booked in a foreign jurisdiction was taxable under Australia law. We have argued elsewhere that this places multinational firms operating in Australia under a threat of double taxation, as there is no reason foreign tax authorities would accept the ATO's claim (Berg and Davidson 2015).

While the Coalition government sought to roll back some of the transparency provisions introduced by the previous Labor government, parliamentary negotiation in December 2015 meant that transparency provisions remained relatively unchanged.[13] The first release of this data occurred that month. While it was accompanied with a warning from the taxation commissioner that "No tax paid does not necessarily mean tax avoidance" (Jordan 2015), the data dump was greeted with headlines such as "How our tax take has been royally Scrooged"

10. Response by Robert Heferen to question from committee chair Sam Dastyari, Official Committee Hansard, Senate Economics References Committee, April 9, 2015, p. 24 (**link**).

11. This was accompanied by a video advertisement (**link**), which stated: "Some multinational companies use Australian businesses and Australian workers to sell products and services to Australian customers every day. But when it comes to sign the contract, the Australian customer is actually signing the contract with a related company in another country. This means Australian income is not being taxed in Australia. To make matters worse, money is then being channelled through to a tax haven, escaping tax worldwide, leaving Australian companies, small businesses, families, and individuals to carry the tax burden. It is unfair and unsustainable for local businesses to pay tax on their profits when their competitors do not. From 1 January next year, this will change. The government will introduce new laws and new penalties to stop this greed, and will consult with the community on further amendments to the Australian tax law. To find out more, visit budget.gov.au."

12. Tax Laws Amendment (Tax Integrity Multinational Anti-Avoidance Law) Bill 2015 (**link**).

13. The Coalition negotiated an increase in the threshold for private company disclosure, from $100 million total income to $200 million, in order to gain Greens support in the Senate.

(Verrender 2015). In December 2016 the second data release occurred. The taxation commissioner made this statement:

> Today's information provides more transparency for the community on the operations of these entities, but it **does not change the level of transparency they have with the ATO**. We already have access to far more detailed information and regularly engage with and assure the tax behaviour of these major players in the Australian economy. (Jordan 2016, emphasis in original)

Not only is the ATO releasing information that it already knows, it is releasing information that is already in the public domain via annual financial statements. Nonetheless, it is worthwhile comparing what the ATO reported with what the media reported. The ATO:

> I should also say we collect, on average, about $2 billion from our compliance activities with these large and private companies each year, which is not reflected in the data released today. (Jordan 2016)

That statement gave rise to the headline "ATO chases multinationals for $2b in unpaid tax" (Mather et al. 2016). The public is left with the impression that multinational tax avoidance amounts to some $2 billion. If correct, that would suggest that multinational tax avoidance constituted some three percent of total company tax revenue. The tax commissioner, however, was referring to *all* compliance matters, not just multinationals. In any event, the ATO still has no clear idea how much revenue is being lost to multinational tax avoidance. An ATO official told the Parliamentary Standing Committee on Tax and Revenue:

> What we have found is that it is very important, if we are to produce a gap, that we are very confident in the underlying methodology, that it is credible and reliable. The superannuation gap, as with a couple of the other income tax gaps, got to a stage where, on external review, they were rated as low or very low reliability.[14]

In short, the transparency policy does not increase tax transparency to the ATO, while it provides the media with an opportunity to report misleading interpretations of information that is already in the public domain. It generates the very misleading impression that the ATO knows how much multinational tax avoidance is occurring, when the ATO in fact has no idea what the extent of

14. Response by Jeremy Hirschhorn to question from committee member Milton Dick, Official Committee Hansard, House of Representatives, Standing Committee on Tax and Revenue, 30 November 2016, p. 15 (**link**).

the problem could be. Overall, this policy assumes that increased exposure, of public information and of information already known to the tax authorities, will lead to less tax avoidance. We are invited to believe that the public has a better understanding of corporate taxation than does the Australian Taxation Office.

The welfare economics of tax competition

Arguments against tax competition often comprise a mixture of declamations with economic argumentation. A domestic political audience with limited economic skills may find such a confused collection of ideas and arguments to be convincing. An example is provided by the former Dutch State Secretary of Finance Wouter Bos, who has argued that while tax competition is all very well in theory, it could never actually work in practice:

> There is nothing wrong with different countries having different tax regimes. Tax policy is a legitimate instrument in improving competitiveness in a global market. A low and competitive tax rate will, among other things, help them to facilitate this goal. In order to pursue and sustain this low tax rate, governments must organise their scarce resources as efficient as possible. From an economic perspective, tax competition therefore leads to efficient governments and the highest possible level of wealth for everybody.
>
> There is only one very important side condition for this last statement to be true, and that is that the global markets are perfect and there are no market failures whatsoever. This is, I am afraid, not the case in real life.
>
> When markets are imperfect, policy goals can not be achieved by market forces alone. The same is true for competing in the field of tax policies. Any competition needs some form of regulation, so does this one. (Bos 2000)

Bos then mentions free-riding and negative externalities. He fails, however, to explain how these problems would manifest in the international taxation system in practice. Finally, he concludes:

> In a perfect world differences between national policy mixes should lead to an optimal mix between the level of taxes and the level of public expenditure on the part of a state. In practice, however, there is a natural tendency to exert pressure to ever lower taxes which could—in turn—threaten the balance between taxes and public expenditures. It is at this point, where fair competition comes close to not just a "race to the bottom" but a "race to public poverty," that fair competition turns into unfair competition and where total tax income of the countries becomes too low for governments to finance a sustainable and sufficient level of public services. (Bos 2000)

Bos frets about tax revenue being "too low" to finance a "sufficient level of public services." A lot rides on the word "sufficient." There is good reason to believe the current size of the public sector has a negative effect on economic growth and productivity (Bergh and Henrekson 2011; Mitchell 2005; Novak 2013). In the British tradition of constitutional government, restraints are needed to keep government from intruding into, and overwhelming, civil society. Just as market competition checks monopolistic abuse, tax competition can exert a healthy check on the 'monopolized' power that is government. Further, Bos suggests that tax competition is not subject to any form of regulation, but that is far from the case. The international tax architecture consists of a complex set of interlocking treaties and conventions that almost amount to an international tax cartel (Edwards and Mitchell 2008). Much like a private-sector cartel, governments have divided up the global tax base and allocated taxing rights over an exclusive domain (see Davidson 2015b). In this view the BEPS debate is simply governments squabbling over prices and market share, as would any private-sector cartel.

Julie Roin (2007a) argues that two chief questions are at the centre of the international tax regime: how much tax should be levied on income generated by transnational transactions, and which government should levy that tax. The international tax architecture establishes which government will levy taxation on income with the overarching principle that income should be taxed only once; governments seldom, if ever, enter into tax sharing agreements. Roin (1995) argues that the international norm is that the source country (i.e., the host economy) has primary taxation jurisdiction over an economic transaction, rather than the home country. The prime objective of most tax treaties is to avoid the problem of double taxation. A chief purpose of these treaties has been to promote international trade and investment.

A consequence of a policy regime designed to avoid double taxation is so-called 'under-taxation.' Roin (2007b) refers to this phenomenon as "double non-taxation." It occurs when the country with primary authority does *not* levy a tax on economic activity. To be clear: Sovereign nations have both the right and the duty to define their own tax bases; in this instance a sovereign nation has chosen to exclude from its own tax base some economic activity over which, by international agreement, it has primary taxation authority.

There are, very often, good reasons why a country may choose to not levy a tax. The most obvious reasons would be to facilitate international trade or encourage foreign direct investment. In other instances, particular income might become tax-exempt due to treaty obligations that have been negotiated between sovereign states. Then, there may well be purely pragmatic reasons related to the mechanics of tax administration. It is important to emphasize that nontaxation by the country with primary taxing authority is a deliberate policy choice, and a

design feature of tax systems. Jawboning countries to tax where they otherwise would choose not to tax could be viewed a form of fiscal imperialism. Edward Kleinbard (2011a; b) argues that international tax architecture creates so-called "stateless income." But the very term "stateless" is misleading: Kleinbard's complaint is not that the income is stateless *per se*, but that it is not taxed in the United States (Davidson 2014a). Similarly, the Australian government's complaints about base erosion and profit shifting can be reduced to the fact that income is not taxed in Australia.

Sovereign nations that have taxing authority under the international tax architecture chose their own tax regimes. Many nations have chosen, for example, to tax intellectual property at lower rates than they do physical property. Unsurprisingly, multinational corporations with valuable intellectual property often locate their property in those countries.[15] These so-called tax havens have come under substantial criticism from international organizations such as the OECD and from high-taxing governments. Yet it is well-known that tax havens promote investment and economic activity. Mihir Desai, Fritz Foley, and James Hines (2006) have found that "tax haven activity enhances activity in nearby non-havens." Higher after-tax returns enable multinational corporations to maintain higher levels of foreign investment. A strong case can be made that the impact a tax haven has on economic activity in neighbor countries is positive, not negative. The question of whether governments suffer adverse revenue effects from tax competition is addressed below.

International taxation arrangements are regulated and constrained by international treaties, domestic law, and business conventions. The international tax architecture operates much like a cartel. It is unsurprising if governments dislike obstacles to their taking more wealth from the private economy, and that the Australian government, which has run persistent and growing budget deficits, would want to renegotiate the rules to gain more tax revenue rather than reduce expenditure.

How significant is profit shifting?

The material published by the OECD and the Australian government makes much of popular perceptions of widespread profit shifting. That material has focused on the mechanisms by which profit shifting might occur, and on the vulnerability of tax systems to aggressive tax planning, but mostly unanswered is how widespread or significant profit shifting is. Here we survey the academic

15. *See* Davidson and Potts (forthcoming) for a discussion on this point.

literature on profit shifting and the use of tax havens. Advances in both method and the acquisition of more fine-grained data have allowed a greater understanding of the extent of profit shifting (Dharmapala 2014).

Observing the growth in multinational firms after the Second World War (Kopits 1976b), the first generation of scholarship to study multinational profit shifting was conducted in the late 1970s and early 1980s. These studies asked whether relative tax rates were likely to influence the behavior of multinational corporations. It was understood that differential taxes and tariffs were an important determinant of transfer pricing (Copithorne 1971; Horst 1971), but data was scarce and little quantitative evidence was available. Exploiting research commissioned by the Colombian government between 1966 and 1970 to identify "overpricing" in the foreign subsidiaries of pharmaceutical firms, Sanjaya Lall (1973) and Constantine Vaitsos (1974) found overpricing ranging from 33 percent to 300 percent, possibly driven by Colombian restrictions on profit maximization. Other studies attempted to indirectly estimate transfer pricing through least squares estimation (Kopits 1976a; Müller and Morgenstern 1974), but lacked actual pricing data.

A second generation of scholarship in the 1990s tried to answer that question by subtracting a counterfactual 'true' income of an affiliate from the observed pre-tax income. The 'true' income was determined by an assessment of the affiliate's capital and labor inputs. The result of this calculation was the profits that had been shifted to the affiliate. James Hines and Eric Rice (1994) and Harry Grubert and John Mutti (1991) exploited country-level aggregated data of U.S. affiliate firms from the U.S. Department of Commerce. Hines and Rice (1994) find that a ten percent decrease in a country's tax rate would be associated with an increase in hypothetical reported profits from $100,000 to $122,500—implying a very large amount of profit shifting (see Dharmapala 2014, 28, Table 1). However, an alternative approach taken in the accounting literature compares the accounting rates of return across United States and foreign operations to derive an estimate of shifted income. Using this method, Julie Collins, Deen Kemsley, and Mark Lang (1998) found no evidence of income shifting out of the United States between 1984 and 1992.

Such analyses were based on country-level or consolidated worldwide data. Aggregating firms together removes important differences between industries, individual firms within an industry, and the structure of tangible and intangible assets. In recent years, however, researchers have been able to employ highly disaggregated data which break down financial information to the affiliate level, using, for example, the Orbis and Amadeus databases. Employing firm-level data, the literature has seen a steady reduction in the estimates of the magnitude of profit shifting. Similarly, controlling for industry-specific shocks and other factors

has reduced estimates further. Table 1, reproduced from Dhammika Dharmapala (2014, 28), demonstrates that studies in the early 1990s reported large estimates of profit shifting but that more recent studies have reported much lower estimates. Dharmapala suggests that a semi-elasticity of 0.8 of pretax income is a consensus estimate, but also points out that a number of more recent studies have reduced that estimate further.

TABLE 1. A summary of BEPS estimates

Study	Data	Period	Semi-Elasticity	Interpretation: a 10% point decrease in a country's tax rate (e.g., from 35% to 25%) is associated with an increase in reported income from $100,000 to:
Hines and Rice (1994)	BEA (country-level)	1982 (cross-section)	2.25	$122,500
Huizinga and Laeven (2008)	Amadeus	1999 (cross-section)	1.3	$113,000
Dischinger (2010)	Amadeus	1995–2005 (panel)	0.7	$107,000
Heckemeyer and Overesch (2013)	Various	Various	0.8 ("consensus" estimate)	$108,000
Lohse and Riedel (2013)	Amadeus	1999–2009 (panel)	0.4	$104,000

Source: Reproduced from Dharmapala (2014, 28, Table 1).

According to the more recent estimates, the extent of profit shifting is quite low. The recent work suggests that multinational firms operating in high-tax jurisdictions shift between 2 percent and 4 percent of their profits to lower tax jurisdictions. Hines (2014) argues that the magnitude is lower again, despite the ample opportunities firms have to exploit tax havens and low tax jurisdictions. Dharmapala (2014) asks whether 2 to 4 percent of income shifted from multinational firms ought to be considered large or small. In our view, a highly relevant policy consideration is the effect that efforts to reduce income shifting would have on the investment climate within the domestic economy. In the OECD BEPS project, the term "base erosion" assumes what needs to be proven: that profit shifting is having a material effect on the domestic tax base.

The evidence for base erosion

The OECD BEPS program is premised on an argument that a country's tax base is, or risks, being eroded by tax avoidance and profit shifting. Such language has been adopted by the Australian government (Australian Taxation Office 2016; Bradbury 2013b). Base erosion is an empirical question. Here we investigate the notion that base erosion has occurred. Peter Birch Sørensen (2007) has provided an analysis where the ratio of company income tax revenue to GDP is decomposed into its component parts:

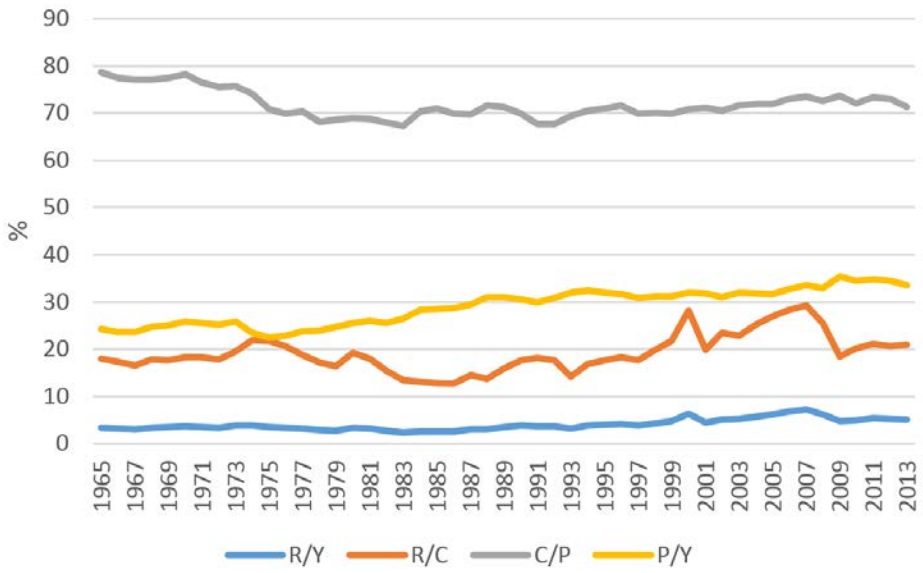
$$\frac{R}{Y} = \frac{R}{C} * \frac{C}{P} * \frac{P}{Y}$$

where R = company income tax revenue, Y is GDP, C is total company profit, and P is total profit earned in the economy. R/C is a proxy for the average effective company income tax rate, C/P is the company share of profits, and P/Y is the profit share of the economy. The decomposition allows us to determine whether any changes in the ratio of company tax revenue to GDP are due to changes in the effective company tax rate or the company tax base (defined as the interaction of the share of company profits and the profit share of the economy).

Following Sørensen (2007), we employ corporate operating surplus as a proxy for corporate profit and total operating surplus as a proxy for total profit. Data for operating surplus and GDP are taken from the Australian Bureau of Statistics and company tax data are taken from the OECD.[16] Sørensen provides the decomposition for several OECD economies over the period 1981 to 2003. In Figure 1, we replicate the decomposition for the period 1965–2013 for Australia. To provide greater clarity we show each of the component series separately in Figure 2.

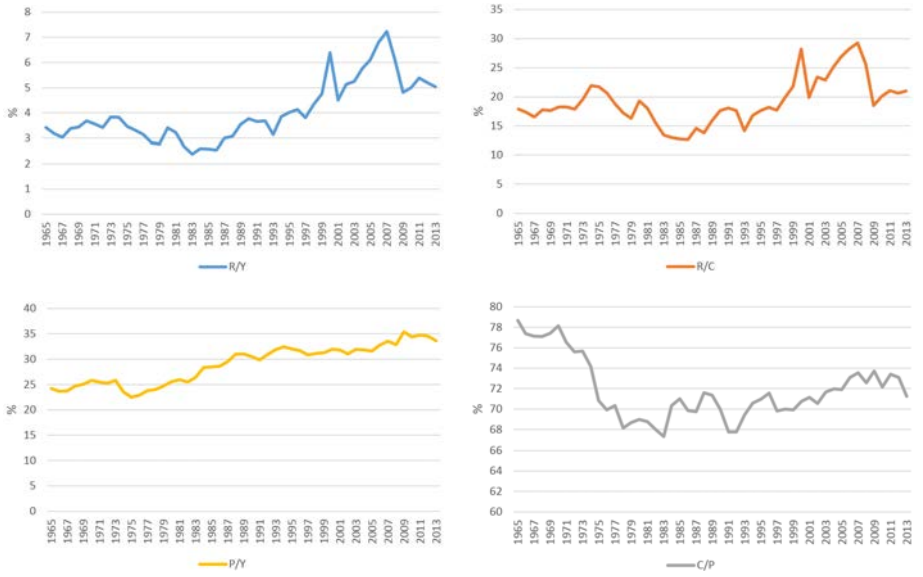
16. Australian Bureau of Statistics, Catalogue 5206.0—Australian National Accounts: National Income, Expenditure and Product (**link**); OECD Tax Database (**link**). There is a question as to whether aggregate time series data can be employed to answer the question we pose. It is always true that aggregate data contain less information than analysts would like. We subscribe, however, to Lord Kelvin's maxim that in the absence of numbers our knowledge is meager and unsatisfactory. Now, *even with numbers* our knowledge may remain meager and unsatisfactory, but this is a problem faced by all participants in the BEPS debate, including the Australian Taxation Office.

Figure 1. Company income tax decomposition for Australia



Source: ABS, OECD iLibrary, and author calculations

Figure 2. Company income tax decomposition for Australia, component series



Source: ABS, OECD iLibrary, and author calculations

As these figures show, the ratio of company tax revenue to GDP has increased since the early and mid-1980s, as has the ratio of company tax revenue to company profits. These changes are largely due to Australia adopting a dividend imputation tax system (see Twite 2001; Cannavan et al. 2004). The profit share of the economy (P/Y) has steadily increased since the mid-1970s while the share of company profits fell until the early 1980s and remained more or less steady after that. The spike in the average effective company tax rate in 2000 is associated with income tax reforms that were introduced to coincide with the imposition of the Goods and Services Tax (the Australian value-added tax on consumption) that was introduced in that year. The decline after 2008 is associated with the global financial crisis and its aftermath. These data do not support the view that the company income tax base in Australia is being eroded. To the contrary, it appears that the Australian company tax base has broadened over time, especially since the early 1980s. This result is consistent with Sørensen's original analysis using a different time period and data source. He too interprets his result as suggesting that the Australian company tax base has broadened, not eroded, over time.

One alternative explanation for our results could be that multinationals have been profit shifting from Australia over several decades, and the problem simply has not gotten any worse since the 1970s and 1980s. We are not convinced by this argument. It invites us to believe that large-scale tax avoidance is occurring while the profit share of the economy is rising. Profit shifting would be consistent with a declining profit share, as 'costs' become inflated. At the same time the company share of profits has been stable since the early 1980s. The decline in the company share of profits over the period of the 1970s is quite consistent with the economic turmoil of those years, and declines also occur during recessions in the early 1980s and early 1990s, and also in the years after the financial crisis of 2007–09. Furthermore the argument that profit shifting was well established by the 1980s and has not changed since then is inconsistent with the argument as to which companies engage in this sort of behavior. BHP Billiton is the largest Australian taxpayer, and in recent years it has been accused of profit shifting through a tax strategy known as a 'Singapore Sling'—but its Singapore hub was established in 2001 (Saunders 2015). Other companies that are regularly singled out for criticism include Amazon, Apple, Adobe, Abbott Laboratories, Facebook, Forest Laboratories, Google, IBM, Johnson & Johnson, LinkedIn, Microsoft, Starbucks, and Yahoo (Chessell 2014). Many of these companies did not exist in the early 1980s. The conditions for the so-called 'Double Irish with a Dutch Sandwich' also were not in place at that time, and many of the companies that have employed that strategy did not exist.

Two other objections might be raised against our approach. It could be claimed that the relevant comparison is not absolute change in the company tax

over time but change relative to what it would be been had stronger anti-BEPS policies been in place in that period. This is a plausible argument, but analysis in support of this claim not been forthcoming. The Australian Taxation Office admits that "Company income tax receipts continue to move in line with macro-economic indicators, reflecting broad compliance by corporates with their income tax obligations" (2015, 34). Our analysis above corroborates that argument. A related claim might be that the long-term stability of company tax revenue reflects a concerted effort to keep Australia's tax laws up to date with business practices. According to Joe Hockey, treasurer in the Abbott government, Australia has some of the "the strongest anti-avoidance laws in the world" (Hockey 2014). Again, the fine-grained analysis that would support such a claim has not been forthcoming, and in that absence, it strikes us as a leap of faith to suggest that individual anti-avoidance reforms have been well-calibrated enough to ensure that company tax revenue is consistent over time.

Conclusion

The corporate tax avoidance debate has many of the hallmarks of a moral panic. A moral panic consists of hyperbolic media and popular claims about threats to the social order, reinforced by political and legislative action that reproduces and amplifies those claims (Krinsky 2013). Moral panics are typically dramatic and sudden, characterized by rhetorical similarity across media and politics, and are "out of all proportion to the actual threat offered" (Hall et al. 1978, 16). This describes the corporate tax debate quite well. It is certainly true that multinational firms seek to minimize their tax liabilities, in Australia as much as anywhere in the world. However, there is little to no evidence consistent with hyperbolic claims about the level of tax paid by multinational firms—often based on misleading or incomplete information—that have been a common feature of Australian news media since the start of the OECD BEPS project. In the context of a federal budget in deficit, with the state of Commonwealth finances being a major political issue, corporate tax avoidance was associated with the constrained fiscal outlook and need for spending reductions. This debate has had a heavily moral dimension. It conveniently locates the source of Australia's budget problems on corporate avarice. An advertisement produced by the Australian government in 2015 accompanying its corporate tax reforms stated that "The government will introduce new laws, and new penalties, to stop this greed."[17] Such language from a right-of-center

17. See note 11 above.

Coalition government echoes that used by left-wing campaigners against corporate tax avoidance.[18]

We have presented an outline of central claims in government discourse about corporate tax avoidance, and evidence that rejects those claims, or at least casts grave doubts on them. Governments of all stripes have a responsibility to maintain a high standard in their discourse about the exercise of their fiscal powers. Corporate taxation is a complex area, and the interaction between domestic tax systems and international taxation architecture is even more so. It is not surprising that there is much public confusion about corporate taxation. It is unfortunate that governments have chosen to exploit, rather than counter, that confusion.

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