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Taxing Multinationals - Truly Addressing BEPS

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Taxing Multinationals 'Post-BEPS' – What's Next?

Maarten Floris de Wilde*

The taxation of multinational companies has been attracting a great deal of attention in recent years. Company tax planning and country tax competition have increasingly been questioned, by the general public, media, in politics and academia. Countries compete for investment, reducing tax burdens on profits. Multinationals respond, shifting profit for tax purposes to low-tax jurisdictions by legally arranging their business affairs in a certain way to optimise their effective corporation tax burdens. Globalisation speeds-up matters. The company taxation models that countries apply today originated in the 1920s. These models were of course designed to cater for interbellum societal, political, economic and business realities, and hence no longer seem 'fit -for -purpose' in today's globalised market place. Corporate tax systems are antique and now appear to be failing, in consequence putting fiscal systems under pressure. The OECD has estimated missed corporate tax revenues at a staggering ¼ of a trillion US dollars a year. To balance budgets, countries resorted to raising tax burdens on consumption and labour. Economic and financial crises that we now seem to have overcome have exacerbated matters, affecting societal trust in the integrity of the tax system. The general public considers tax bill increases unfair if they are not addressed to multinationals, but imposed on their workers and customers instead. It is often heard that moral obligations to finance expenditure apply equally to multinationals.

The cocktail of 'races to the bottom', economic and fiscal crises, austerity measures, fiscal consolidation and social hardship and public discontent lead to an unprecedented political prioritisation of corporate taxation. On 5 October 2015, the OECD published the outcomes of its Base Erosion and Profit Shifting (BEPS) Project it had undertaken at the request of G20 in 2012. This marked an unprecedented turning point in the history of international company taxation. Throughout 2016 and 2017 the European Union adopted a number of the OECD's anti-BEPS measures on an EU-wide basis with a view to addressing multinational tax avoidance practices via hard law measures. At the international level, the treaty-related aspects of the BEPS initiative are covered by the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting'. The treaty is open for ratification, and close to 70 countries have already signed it during the first signing round held on 7 June 2017 in Paris, France. However, all the measures undertaken appear to refurbish existing anti-tax avoidance approaches, thereby leaving the root causes of a failing international corporate tax framework essentially intact.

We have been pursuing the 'post-BEPS' path that we embarked on a couple of years ago, so perhaps now is a good time to take stock of where we are along the route. This special edition of *Erasmus Law Review*, comprising five contributions, addresses some pivotal topics concerning the taxation of multinationals' profits in a 'post-BEPS' globalising market environment.

Reuven Avi-Yonah and Haiyan Xu evaluate the BEPS project of the G20 and OECD and offer some alternatives for reform. They argue that the problems of base erosion and profit shifting stem from the 'benefits principle', the independent entity principle and the arm's length principle. They contend that adhering to existing tax paradigms is unlikely to help achieve the envisaged taxation at the location of value location. They advocate 'flipping' of the system and consider the possibility of taxing passive income primarily at source and active income primarily at residence.

Hans Gribnau evaluates issues in corporate taxation from an ethical perspective. Who is to be held responsible? Is it firms, their consultants, governments? Gribnau argues that the international tax system is the result of the interaction of different actors who all share the responsibility for its integrity. Both states and multinationals – and their advisors – make choices that affect its operation, and this brings moral responsibility. This means that countries should cooperate in an effort to improve the system and that companies should avoid acting irresponsibly and desist from aggressive tax planning operations, Gribnau argues.

Irene Burgers and Irma Mosquera examine differences in perceptions of 'fairness' between developed and developing countries on the issue of taxing multinationals. Does the BEPS initiative strike a fair balance between their needs and interests? Perhaps not, Burgers and Mosquera argue, pointing out fundamental legitimacy concerns in this regard, observing that the needs of developing countries differ from those of the developed countries while developing countries did not actually participate in negotiation and decision-making processes when G20 and OECD formulated their anti-

* PhD, LLM, Erasmus University Rotterdam and Loyens & Loeff. This paper is part of the Erasmus School of Law's faculty research programme on Fiscal Autonomy and Its Boundaries.

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BEPS plans. Hence, the BEPS project predominantly reflects a compromise between rich countries, as is exemplified by the absence of measures to alter the existing balance of allocation of tax rights between 'residence' and 'source countries', though a lasting point of contention for developing countries. Burgers and Mosquera, in a manner akin to Avi-Yonah and Xu, argue in favour of a more profound role to be assumed by the United Nations in the discussion on balancing global responses to base erosion and profit shifting.

Weber adopts an EU law perspective to compare anti-treaty abuse approaches in the BEPS initiative against its counterpart concepts found in EU law in the field of direct taxation. Weber contends that if the OECD abuse test is stricter then generally recognized in academic literature and that the test is in line with the EU law concept of legal certainty, it is also going beyond the scope of EU abuse of law doctrines. Contrary to EU law abuse doctrines, the OECD's approach does not seem to resort to the artificiality of the intra-firm legal arrangements as a substantive criterion to establish the presence of abuse; indeed, a recipe for some heated discussion and future litigation.

Turning full circle, tax practitioners Harmen van Dam and Paul Lankhorst assess post-BEPS company tax environments from the advisory angle. They argue that the BEPS initiative, in attempting to align taxation and the location of value creation while maintaining the concepts of separate accounting and arm's length pricing, stretches existing tax rules to breaking point. The OECD seems to be wanting to tax profits by reference to sales and employee locations, Van Dam and Lankhorst observe, opining that if this is so, one should then step away from traditional transfer pricing approaches. The BEPS initiative, however, does not, leaving many legal uncertainties and lots of red tape when it comes to establishing taxpayers' tax positions.

Thus, 'Taxing Multinationals 'Post-BEPS' – What's Next?' As said, winds of change have been blowing through the world of international company taxation. Similar to the position taken by Avi-Yonah and Xu, my own opinion is that the BEPS project is not the final destination. The BEPS initiative has left the foundation concepts of international company taxation intact, along with its key problems. I do not think that these will truly be resolved, at least not as long as the international tax framework is left unaffected. Perhaps the BEPS project will prove a first step towards a fundamental remodelling of the international corporate tax regime. Or, perhaps not; status quos tend to be pretty persistent. Nevertheless, discussions on fundamental corporate tax reform surely have not ceased since the OECD released its BEPS outcomes in October 2015. On the contrary, we have seen many ideas, suggestions, and proposals for fundamental reform brought forward, ranging from unitary models to destination-based cash flow taxation in a variety of forms. On 25 October 2016, the European Commission released proposals for a Council Directive on a Common Corporate Tax Base (CCTB) and a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB), relaunching its envisaged formulary apportionment system for the internal market. If adopted, the CCTB/CCCTB directives would effectively introduce a single, EU-wide corporate tax system for large multinationals, thus replacing the separate national systems currently operating in the 28 Member States. Time will tell.

I would like to express my heartfelt gratitude to the authors for their truly excellent contributions, and to the peer reviewers, of course, for their outstanding reviews and feedback. The best of luck to all of you, and again, many thanks for all your work and effort to make this special issue a success. Many thanks, too, to Margaux Raynaud and Nettie Dekker for your support and assistance in putting this edition together. And thanks, finally, to Kristin Henrard from the editorial board, for giving me the opportunity to put an edition of *Erasmus Law Review* together on this fascinating subject. Dear reader, I wish you a good read.

Evaluating BEPS

Reuven S. Avi-Yonah & Haiyan Xu*

Abstract

This article evaluates the recently completed Base Erosion and Profit Shifting (BEPS) project of the G20 and OECD and offers some alternatives for reform.

Keywords: tax avoidance, tax evasion, benefits principle

1 Introduction: The Financial Crisis and Inequality

The financial crisis of 2008 and the Great Recession that followed have raised anew the problem of how to address a growing inequality both between the rich and everybody else within countries, and between developed and developing countries. Both dimensions of inequality, the intra- and inter-country ones, have risen in this century, and the Great Recession has made both problems worse. The current rise of populism in both the US and Europe and the vehement reactions to a tide of migrants from poorer to richer countries show how these two problems are intertwined.[1]

In the year 2000, the first author wrote about the challenge that globalisation and tax competition pose to the fiscal viability of the post-World War II welfare state.[2] He pointed out that if tax evasion by rich individuals and tax avoidance by multinational corporations is allowed to undermine the ability of both developed and developing countries to provide adequate social insurance for their citizens, a violent reaction against globalisation may ensue that risks ending this era of opening borders, just like World War I ended the previous era of globalisation a century ago. Today we worry that the lack of adequate response to the Great Recession is leading to the rise of violent anti-globalisation sentiments on both the right and the left, embodied in the US by the success of Bernie Sanders and Donald Trump and in Europe by an even more virulent rejection of the open border policies the EU has stood for.[3]

It is imperative for the West to find ways to strengthen the ability of the state to provide adequate social insurance and reduce inequality before these forces lead to the closing of the borders and to pressures that could result in the end of the current era of globalisation. But the response so far has unfortunately not been adequate.

Following the financial crisis and ensuing austerity, politicians discovered the problem of tax avoidance. On the corporate tax avoidance front, the OECD and G20 launched the Base Erosion and Profit Shifting (BEPS) project in 2013, and this has in October 2015 culminated with the release of a series of action steps that the OECD and G20 countries have undertaken to adopt.[4] OECD Secretary-General Angel Gurria has stated that

> Base erosion and profit shifting affects all countries, not only economically, but also as a matter of trust. BEPS is depriving countries of precious resources to jump-start growth, tackle the effects of the global economic crisis and create more and better opportunities for all. But beyond this, BEPS has been also

* Reuven Avi-Yonah is Irwin I. Cohn Professor of Law, the University of Michigan. Haiyan Xu is Professor of Law, University of International Business & Economics, Beijing; SJD candidate, the University of Michigan. The authors would like to thank participants in workshops at NYU and Duke Law schools for comments, and Itay Peer for invaluable research assistance.

1. *See, e.g.* P. Noonan, 'Trump, Sanders and the American Rebellion', *WSJ*, 2/11/16; available at: <http://on.wsj.com/1QavpWY>.
2. R. Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State', 113 *Harv. L. Rev*. 1573 (2000).
3. Noonan, above n. 1; <www.bbc.com/news/world-europe-24583286>.
4. On BEPS *see, e.g.*, P. Saint-Amans and R. Russo, 'The BEPS Package: Promise Kept', 70 *IBFD Bull. Int. Tax*. 4 (2016); H.J. Ault, 'Some Reflections on the OECD and the Sources of International Tax Principles'. Reprinted from 70 *Tax Notes Int*. 12 (2013), at 1195; Working Paper of the Max Planck Institute for Tax Law and Public Finance No. 2013-03. Available at SSRN: <http://ssrn.com/abstract=2287834> or <http://dx.doi.org/10.2139/ssrn.2287834>; D. Dharmapala, 'What Do We Know about Base Erosion and Profit Shifting? A Review of the Empirical Literature,' *Illinois Public Law Research Paper* No. 14-23; *University of Chicago Coase-Sandor Institute for Law & Economics Research Paper* No. 702 (2014). Available at SSRN: <http://ssrn.com/abstract=2373549> or <http://dx.doi.org/10.2139/ssrn.2373549>; Y. Brauner, 'What the BEPS?', *University of Florida Levin College of Law Research Paper* No. 15-40 (2014). Available at SSRN: <http://ssrn.com/abstract=2408034> or <http://dx.doi.org/10.2139/ssrn.2408034>; H.J. Ault, W. Schoen & S. Shay, 'Base Erosion and Profit Shifting: A Roadmap for Reform', 68 *Bull. Int. Tax*., 275 (2014); *Boston College Law School Legal Studies Research Paper No*. 324. Available at SSRN: <http://ssrn.com/abstract=2459646>; D. Dharmapala, 'Base Erosion and Profit Shifting: A Simple Conceptual Framework', *University of Chicago Coase-Sandor Institute for Law & Economics Research Paper* No. 703 (2014). Available at SSRN: <http://ssrn.com/abstract=2497770>; R.J. Vann, 'Policy Forum: The Policy Underpinnings of the BEPS Project-Preserving the International Corporate Income Tax?' 62(2) *Can. Tax J*. 433, at 433-41 (2014); *Sydney Law School Research Paper* No. 14/77. Available at SSRN: <http://ssrn.com/abstract=2483619>; D. Shaviro, 'The Crossroads versus the Seesaw: Getting a "Fix" on Recent International Tax Policy Developments', *NYU School of Law, Public Law Research Paper* No. 15-20, *NYU Law and Economics Research Paper* No. 15-11 (2015), Available at SSRN: <http://ssrn.com/abstract=2605144> or <http://dx.doi.org/10.2139/ssrn.2605144>; A.H. Rosenzweig, 'Building a Framework for a Post-BEPS World', 74 *Tax Notes Int*. No. 12 (2014). Available at SSRN: <http://ssrn.com/abstract=2463259>; I. Grinberg, 'Breaking BEPS: The New International Tax Diplomacy', *Georgetown University Law Center* Draft (1 September 2015). Available at SSRN: <http://ssrn.com/abstract=2652894> or <http://dx.doi.org/10.2139/ssrn.2652894>.

eroding the trust of citizens in the fairness of tax systems worldwide. The measures we are presenting today represent the most fundamental changes to international tax rules in almost a century: they will put an end to double non-taxation, facilitate a better alignment of taxation with economic activity and value creation, and when fully implemented, these measures will render BEPS-inspired tax planning structures ineffective.[5]

Is Mr. Gurria justified in his optimism? We do not think so. These efforts are commendable and to some extent have an impact. But in our opinion they are inadequate. The basic problem is that they take as a given the fundamental consensus underlying the international tax regime, also known as the 'benefits principle'. Under the benefits principle, active (business) income should be taxed primarily at source while passive (investment) income should be taxed primarily at residence.[6] This compromise between the claims of residence and source countries was reached in 1923 and still serves as the foundation of the international tax regime.[7] It is embedded in over 3,000 bilateral tax treaties and in the domestic laws of the US and most other countries. Not surprisingly, it is also reflected in BEPS, which is an attempt to improve source-based taxation of active income.[8]

In our opinion, the benefits principle should be reconsidered, because the reliance on source-based taxation for active income and residence-based taxation for active income requires cooperation by too many jurisdictions. The problems of BEPS stem from its reliance on the benefits principle.

In the case of active income, the justification for taxation at source has been that most such income is earned by corporations that have no fixed residence. However, since the 1980s, tax competition has led many source jurisdictions to offer tax holidays to multinationals, and residence jurisdictions are reluctant to tax their multinational on their global income so as not to put them at a competitive disadvantage. The result has been that most multinationals are not taxed currently at source or at residence.

Two recent examples can be used to illustrate the problem of tax avoidance on cross-border income:[9]

As of the end of 2015, US multinationals had over $2 trillion in offshore profits in low-taxed jurisdictions.[10] This amount, which translates to about $700 billion in US taxes avoided, is mostly income that was economically earned in the US and shifted offshore to jurisdictions like Singapore, Ireland or Luxembourg, which have effective tax rates in the single digits.

How do the multinationals do it? A couple of examples can suffice. Apple, Inc. is the world's largest company by market capitalisation. Most of its billions in profits relate to intellectual property developed at its headquarters in Cupertino, California. But for tax purposes, most of the profit is booked in its Irish subsidiaries – let's call them Apple Ireland.[11]

Some of the profit shifting is achieved through a 'cost sharing agreement'. Cost sharing is a concept developed in IRS regulations in the 1980s, but which became more significant due to the increasing importance of intellectual property. The idea behind cost sharing is this: When a US multinational begins a new research project (for example, a search for a drug to treat a certain disease), it can agree to share the costs of development with its offshore subsidiaries. Then, if the project is successful, the parties share the profits in the same proportions. For example, if Apple Ireland contributed 80% of the costs of developing the iPhone 6, it would get 80% of the profit. Importantly, none of the actual work is done by Apple Ireland. Apple just gives Apple Ireland the money and Apple Ireland pays it back as its contribution to the research costs.

Why would the IRS regulations permit this? Because if the research failed, then the taxpayer would lose its ability to deduct the costs sent offshore. The more of the cost sent offshore, the more deductions would be at risk. So the IRS thought there was a natural limit to taxpayer's willingness to share costs with offshore affiliates.

That analysis may have been true for Big Pharma, which usually waits to enter into cost sharing with an offshore affiliate until a drug has passed its initial trials and is well on its way to a patent, and then battles the IRS over valuation issues at the time the cost-sharing agreement was executed. But the same analysis makes no sense for Apple, since if there is anything certain in business, it is that a new version of the iPhone will sell.

There is another trick involved in Apple Ireland's profitability. Another portion of its profits derive from countries where Apple sells the iPhones. Apple Ireland licenses the right to use Apple's brand and intellectual property to Apple affiliates in other countries. Those affiliates in turn pay Apple Ireland hefty royalties, which operate to shift the sales profits gained in those countries to Ireland.

Before 1997, such a scheme would not have worked, because the royalties received by Apple Ireland would have triggered a tax in the US under so-called Subpart F. But in 1997 the Clinton Administration adopted a rule called 'check the box'. Under check the box, Apple Ireland can treat all of its foreign affiliates as if they did not exist as separate entities for US tax purpo-

5. OECD, Centre for Tax Policy and Administration, 'OECD presents outputs of OECD.G20 BEPS Project for discussion at G20 Finance Ministers' meeting, 5 October 2015.
6. On the benefits principle and its origins, *see* R. Avi-Yonah, 'The Structure of International Taxation: A Proposal for Simplification', 74 *Texas L. Rev*. 1301 (1996); R. Avi-Yonah, 'International Taxation of Electronic Commerce', 52 *Tax L. Rev*. 507 (1997); R. Avi-Yonah, *Advanced Introduction to International Tax Law* (2015), ch. 1.
7. Avi-Yonah (1996), above n. 6.
8. On the ideas behind BEPS, *see, e.g.* Ault (2013), above n. 4, at 1195.
9. These examples are based on R. Avi-Yonah, 'International Tax Evasion and Avoidance: What Can Be Done?' *The American Prospect* (2016).
10. Available at: <http://ctj.org/ctjreports/2015/07/21_trillion_in_corporate_profits_held_offshore_a_comparison_of_international_tax_proposals.php#.VroUufkrLmg>.
11. Available at: <https://www.gpo.gov/fdsys/pkg/CHRG-113shrg81657/pdf/CHRG-113shrg81657.pdf>.

ses and treat the money they paid to Apple Ireland as income earned in Ireland. The result is that for US tax purposes there are no royalties and no US tax triggered by them, because Apple Ireland treats the money as its own sales income.

The Obama Administration came in promising to repeal check the box; this was the biggest international revenue raiser in the first Obama budget. But by November 2009 the Administration recanted under pressure from the multinationals. On December 18, 2015, President Obama signed into law a five-year extension of a provision (first enacted by a Republican Congress as a 'temporary' measure in 2006) that enshrines check the box in the tax law.

Finally, the Senate hearing revealed two Irish-specific tricks used by Apple. Ireland has a tax rate of 12.5%, far below the US rate of 35%. But Apple did not want to pay even 12.5%. Its solution was ingenious: For US tax purposes, Apple Ireland is treated as an Irish company because it is incorporated in Ireland, so it is not taxed by the US. But for Irish tax purposes, Apple Ireland was treated as an American company because it is 'managed and controlled' from California. As a result, Apple Ireland claimed it was a tax resident nowhere. On top of that, it negotiated a sweetheart tax deal with Ireland for its Irish income that resulted in its paying a tax rate of less than 2%.

These types of tricks are used by most US multinationals. If the primary driver of value of a US multinational is intellectual property developed in the US, the Apple scheme can simply be replicated.

But what if the value derives from more traditional, tangible items? Some US multinationals do pay higher taxes (e.g. the car companies). But others try to avoid tax nevertheless. Caterpillar, Inc. is a good example.[12]

Caterpillar does not make a lot of money on the heavy equipment it manufactures. But it makes a bundle on replacement parts, because once you buy a Caterpillar bulldozer, you will need parts, which you can obtain only from Caterpillar at a huge mark-up. Caterpillar prides itself on its ability to deliver parts within 24 hours anywhere in the world, including the Arctic tundra (where its equipment is used in mineral extraction).

Before 1998, Caterpillar bought the parts from unrelated manufacturers and stored them at its warehouse in Morton, Illinois. When a dealer requested a part for a customer overseas, Caterpillar 'sold' (but did not actually ship) the part to a Swiss subsidiary, which in turn sold the part to the unrelated dealer.

The problem, according to accounting firm PriceWaterhouseCoopers, was that Caterpillar's sale of the part to its Swiss subsidiary triggered US tax. Much better, PwC said, would be if the parts were sold by the manufacturer directly to the Swiss subsidiary, which could then sell it to the dealer.

Fine, said Caterpillar, but we do not want to change our operations. So in exchange for $60 million in fees, PwC came up with a way to lower Caterpillar's US tax without changing its operations. PwC's solution was for the manufacturers to bill the Swiss subsidiary for the parts but continue to ship them to the Illinois warehouse, which continued to transport them to Caterpillar's foreign customers. If the parts were shipped overseas, they were deemed to have been 'owned' by the Swiss subsidiary, and PwC devised a virtual inventory to track them even though the parts were indistinguishably commingled in the warehouse. The result was that Caterpillar continued to run its parts business from the US, but declared 85% or more of the parts profits in Switzerland.

The IRS has now challenged this billing arrangement, which resulted in shifting some $2.4 billion in Caterpillar profits from the United States to Switzerland. A Grand Jury has issued subpoenas under a criminal investigation for tax fraud.

But the disturbing fact is that the whole story would not have come to light but for a whistle-blower, who alerted both the US Senate Permanent Subcommittee on Investigations and the IRS. And while Caterpillar is facing a court challenge, in most cases of corporate tax avoidance, like Apple, the IRS' hands are tied because what Apple did may have been legal under the US tax code.

The fundamental problem of BEPS stems from its reliance on the benefits principle. BEPS seeks to bolster source-based taxation of active income, but it does not apply to countries outside the OECD/G20, and its scope is quite limited as discussed below.

To preserve the income tax in the 21st century, multilateral solutions are needed. BEPS is multilateral, but it is hampered by the fact that there are too many source jurisdictions for active income. If we reversed the benefits principle so that passive income is taxed primarily at source and active income at residence, far fewer jurisdictions will need to cooperate.

For passive income, the number of source jurisdictions is much smaller than residence jurisdictions. Because most individuals are relatively risk averse, portfolio investment flows overwhelmingly to a small number of countries - the US, the EU and Japan. Even the BRICS mostly attract portfolio investment through mutual funds that are relatively easy to tax. Thus, if the 'big three' can coordinate to reinstate a withholding tax on interest, dividends and royalties flowing from them, most of the problem of taxing passive income can be solved. Crucially, money cannot stay in tax havens and earn decent rates of return, so the cooperation of tax havens is not needed.

For active income, about 90% of large multinationals are headquartered in the G20, and none of those countries has a tax rate below 20%, so if they taxed their multinationals currently on a coordinated basis and

12. Available at: <www.hsgac.senate.gov/subcommittees/investigations/hearings/caterpillars-offshore-tax-strategy>.

restricted the ability to move out, most of the problem would be resolved.[13]

We would therefore suggest that we reconsider the benefits principle in light of the reality of globalisation. We should tax passive income primarily at source and active income primarily at residence.

Importantly, like under current rules, this does not preclude the alternative. Once passive income is taxed at source, taxpayers may be able to credit the tax upon declaring it to their residence country. And once active income is taxed at residence, a credit can be given to source country taxes if the source country responds to the limitation of tax competition by re-imposing its tax. But the key is that the income has already been taxed, so that no double non-taxation ensues even if taxpayers do not declare the income (in the case of passive income, where the residence rate may be higher) or source countries choose not to tax in the case of active income.

The following unpacks this analysis in more detail. Section 2 analyses the BEPS response to corporate tax avoidance and its shortcomings. Section 3 develops the alternative: Taxing passive income primarily at source and active income primarily at residence. Section 4 concludes.

2 The Limits of the BEPS Project

On 5 October 2015, the OECD and G20 released the final BEPS package of 13 reports, which cover 15 actions.[14] It was only two years since the G20 leaders endorsed the ambitious and comprehensive Action Plan to address BEPS at the meeting in St. Petersburg on 5-6 September 2013.

The BEPS package represents the first substantial – and overdue – renovation of the international tax standards in almost a century.[15] The BEPS package is an unprecedented turning point in the history of international tax law. The mission of the BEPS package is to align the location of taxable profits with the location of economic activities and value creation. Some generally accepted principles of international tax law, including the single tax principle, the benefit principle, the anti-discrimination principle and the transparency principle have been reflected in many respects.

Despite considerable progress, there are many shortcomings with the BEPS project due to the short two-year framework. Hence, the BEPS project is not the final destination of international tax law reform. In fact, it is the first step towards the modernisation of global tax governance in the long run.

2.1 New Shoes on the Old Road: An Old Approach for the New Destination

The primary problem with the BEPS project is that although the new destination has been redefined, new principles and new rules have not been truly established for the new direction, and the old principles have been strengthened by a patch up of current rules.

The core principle of international tax law is the single tax principle, which requires eradication of both double taxation and double non-taxation.[16] Unfortunately, both the governments and the MNEs have been active in fighting against the double taxation, and have ignored another danger of double non-taxation. Therefore, the main theme of traditional international tax law has been eradication of double taxation, instead of double non-taxation.

Based on the single tax principle, the mission of the BEPS project is to prevent and eliminate the double non-taxation. As the G20 leaders pointed out the new principle, 'profits should be taxed where economic activities deriving the profits are performed and where value is created'.[17] Therefore, the new direction of international tax law reform in the context of BEPS project is to safeguard the single tax principle by fighting against the BEPS.

It is well known that the rickety international tax regime, including rules and underlying principles, is one of the primary root causes of BEPS opportunities.[18] Therefore, the new direction demands revolutionary changes to current approaches. The ideal roadmap for the BEPS project is supposed to replace the old principles with a new principle, and to redesign the rules based on the requirement of the new principle.

Unfortunately, many old principles of international tax law have been preserved and continued in the final BEPS package. The mixture of new principle and old principles has substantially compromised the value of the new principle, and made the legal reform of international tax look more like the patch-up of existing rules and principles. The reason is pretty obvious. On the one hand, it is impossible to abolish or even reconsider the dysfunctional current rules, which have been favoured by some large countries and MNEs. On the other hand, it is mandatory to change the current rules to some extent, because of the emerging political pressure against BEPS schemes.

Given the fact that two years are very short for serious in-depth research, debate and negotiation, given the

13. For the location of the world's 100 largest multinationals, *see* the Forbes 2000 list, available at: <www.forbes.com/sites/liyanchen/2015/05/06/the-worlds-largest-companies/#4ebf4ea14fe5> (89% are in G20 countries); for the tax rates of the G20, *see* <https://www.flickr.com/photos/hmtreasury/7003545741>.
14. Available at: <www.oecd.org/tax/beps-2015-final-reports.htm>.
15. OECD, 'Explanatory Statement', *OECD/G20 Base Erosion and Profit Shifting Project* (2015), at 5.
16. Ault (2013), above n. 4; R. Avi-Yonah, 'Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy', *59 NYLS L. Rev*. 305 (2015); R. Avi-Yonah, 'Full Circle? The Single Tax Principle, BEPS, and the New US Model', *U of Michigan Public Law Research Paper No*. 480 (2015); *U of Michigan Law & Econ Research Paper No*. 15-019. Available at SSRN: <http://ssrn.com/abstract=2673463> or <http://dx.doi.org/10.2139/ssrn.2673463>.
17. Tax Annex to the St Petersburg Declaration, September 2013.
18. Ault (2013), above n. 4. Hugh Ault was the principal theoretical contributor to the BEPS project in his role as senior adviser to OECD.

strong tradition and interest groups desire to keep the continuity of old principles, given the global voice for closing up the BEPS opportunities, the architect of the BEPS project has no choice but to patch up some loopholes of current rules, instead of fundamental restructuring of current regime.[19]

As a result, complete renovation of current international tax law did not happen, and genuine new rules guided by the new principle have not been formulated. Moreover, the patch-up work has produced many more complex, discretionary, uncertain, costly and in many cases contradictory rules.[20] There are two possible negative consequences. First, it is difficult to translate all the new rules into the reality. Second, even if the BEPS project is implemented as outlined and promised in the book, it is still possible for the creation of either new BEPS opportunities on the part of MNEs, or arbitrariness on the part of tax authorities.

In addition to adhering to the independent entity principle and rejection of the new principle of single unitary entity, the BEPS project is also silent on the basic concepts of residence and source, and where profit should be considered to be earned. As the existing rules based on the old principles have been strengthened, and new rules based on the new principle have not been established, the BEPS project is not so revolutionary and fundamental as it appears at the first sight.

The ironic fact is that the patch up of current rules in the BEPS project was made in the name of new mission and new principle. However, because of the inconsistencies and conflicts between the new principle and old principles, the new principle of international tax law has been compromised or undermined by the strengthened current rules based on old principles. Without the support of new principle and new rules, it is very challenging to achieve the new destination of aligning the taxation of MNE profits with economic activity.

2.2 The Survival and Continuity of Notional and Illusionary Independent Entity Principle and Arm's Length Principle

The traditional international tax law is designed and interpreted based on the assumption that the various constituent entities or members of MNE group are independent of each other and conduct transactions with each other at arm's length.[21]

While criticising the independent entity theory as a fundamental flaw of the existing rules, the BEPS Monitoring Group identified a new but implied approach in the G20 mandate to treat the corporate group of an MNE as a single firm, and ensure that its tax base is attributed according to its real activities in each country.[22] This means that the new destination of taxing MNEs 'where economic activities take place and value is created' is unlikely to be achieved, without treating the MNE group as a single firm.

We also support the single unitary entity principle.[23] In our view, the G20 mandate could be interpreted as both a new direction and a new guiding philosophy, which requires all the BEPS actions to serve the purpose of taxing MNEs where economic activities take place and value is created in the most efficient manner. Guided by the brand new philosophy, the principle of single unitary entity and the basic concepts of residence and source need to be established as the cornerstones to support the design, interpretation and implementation of new measures in the BEPS package.

Unfortunately, the BEPS project refused to make the implied principle explicit, but has continued to emphasise the independent entity principle, while attempting to counteract its harmful consequences. Consequently, the BEPS outputs fail to provide a coherent and comprehensive approach, and offer instead proposals for a patch-up of existing rules, making them even more contradictory and complex.[24]

According to our observation, virtually all the new rules of the BEPS package are still built on the notional principle of independent entity.[25] By its very nature, the untouchable principle of arm's length ultimately derives from the root of independent entity theory. In addition, many other flawed rules including weak CFC rule; territorial and deferral systems are also indirectly but closely connected with the independent entity principle.

The orthodoxy of independent entity taxation has two basic assumptions. First, the members of the MNE group are regarded as equal, separate and independent legal persons. Namely, the members of MNE group are reasonable legal entities. From the perspective of corporate law, the fiction of independent entity in the context of a corporate group derives from the orthodoxy of shareholder's limited liability and the corporate independent status as legal persons in the traditional corporate law. Second, the contracts between the related parties in the corporate group are freely negotiated at arm's length, and the terms of the contract are fair and reasonable dealings.[26] In short, both the entities and the transactions in the corporate group are reasonable, therefore legal and moral.

19. Ault (2013), above n. 4.
20. *See* detailed discussion below, and the report card prepared by the BEPS Monitoring Group, available at: <https://bepsmonitoringgroup.wordpress.com/2015/10/05/overall-evaluation/>.
21. R. Avi-Yonah, 'The Rise and Fall of Arm's Length: A Study in the Evolution of U.S. International Taxation', 15 *Virginia Tax Rev*. 89 (1995); R. Avi-Yonah, 'Between Formulary Apportionment and the OECD Guidelines: A Proposal for Reconciliation', 2 *World Tax J*. 3 (2010); R. Avi-Yonah and I. Benshalom, 'Formulary Apportionment – Myths and Prospects', 3 *World Tax J*. 371 (2011).
22. The BEPS Monitoring Group (BMG), 'Overall Evaluation of the G20/OECD Base Erosion and Profit Shifting (BEPS) Project', available at: <https://bepsmonitoringgroup.wordpress.com.
23. For a detailed proposal with legislative language, *see* R. Avi-Yonah, K. Clausing & A. Durst, 'Allocating Business Profits for Tax Purposes: A Proposal to Adopt a Formulary Profit Split', 9 *Fla. Tax Rev*. 497 (2009); R. Avi-Yonah, 'A Proposal for Unitary Taxation and Formulary Apportionment to Tax Multinational Enterprises', in P. Dietsch and T. Rixen (eds.), *Global Tax Governance* (2016) at 289. We support these proposals, but given the strong opposition of both OECD and the US Treasury, we regard them as longer-term prospects than the proposal in this article.
24. The BEPS Monitoring Group, above n. 22.
25. *See* BEPS Action Plan 8-10.
26. *See* Avi-Yonah, Clausing & Durst, above n. 23.

However, the two beautiful and attractive assumptions do not make sense, and they do not really exist in the commercial reality. The primary commercial reality is that a multinational corporate group operates more like a single, unitary entity or enterprise rather than separate independent entities or enterprises. This is made possible by the controlling power of the parent corporation. As traditional international tax law stubbornly insists on the old concept of independent entity, the MNEs have been encouraged to incorporate dozens and even hundreds of affiliates all over the world to undertake aggressive BEPS schemes.[27] The more subsidiaries or members in the MNE family, the stronger the parent corporation in reducing the overall transaction cost, and advance the profitability of the group as a whole. Why?

The answer is very simple. All the commercial activities of the subsidiaries and affiliates are under the effectively direct or indirect control from the parent corporation. Therefore, the profits or benefits could be unlimited by separate but coordinated operations of business under the uniform controlling power. On the other hand, the principle of independent entity could better protect the MNEs from unlimited risks and liabilities of group members towards *bona fide* third parties including the tax authorities. Therefore, the legal risks and liabilities of corporate group are limited by law, because there is no joint and several liability between and among the group members unless otherwise agreed by the corporate group members.

Because of the controlling power of the parent corporation on the top of the pyramid of the complicated corporate structure, like a smart spider at the centre of a grand network of corporate groups, it is unlikely to find real arm's length transaction in the reality.[28] In fact, the related party contracts within the corporate group are always concluded without seriously free, competitive and transparent bargainings and negotiations.

If the BEPS project is designed on the principle of single unitary entity, the BEPS counter-measure will be much more simple and effective, as inter-group transactions will be disregarded, and the profit or tax base will be attributed to its real activities that generate the profit and create the value in the jurisdictions.

Unfortunately, many actions of the BEPS project, including but not confined to Action 2 on hybrid mismatches, Action 7 on PE, and Actions 8-10 on transferring pricing, heavily rely on the legal fictions of independent entity and arm's length transaction.[29]

2.3 The Survival and Continuity of the Problematic Benefit Principle

The OECD declared that, the goal of BEPS package is 'to tackle BEPS structures by comprehensively addressing their root causes rather than merely the symptoms. Once the measures are implemented, many schemes facilitating double non-taxation will be curtailed.'[30] Therefore, a key question is whether all root causes, instead of symptoms, have been addressed?

In our opinion, one of the root causes is traditional benefit principle, which has guided the allocation of global profits in the past decades, and has created many BEPS opportunities. Unfortunately, the BEPS project failed in replacing the benefit principle. Instead, the BEPS package was still designed based on residence jurisdictions for passive income and source jurisdictions for active income.

As articulated in this article, our argument is that BEPS concerns will be more effectively tackled if passive income is primarily taxed at source and active income is primarily taxed at residence. This new philosophy will help to build a new international tax governance framework of win-win, which will benefit both developed countries and developing countries. Moreover, the conflicts between the domestic demand for tax revenue and domestic policy to attract foreign direct investment will be better balanced, and the MNEs and domestic firms will be offered a level playing field.

Many scholars have realised the significance of the renovation of basic principles of current international tax law. As Mindy Herzfeld argued,

> attempts at coordination cannot be successful unless there is agreement on an underlying set of principles for allocating the revenue of global citizens (including natural persons and legal entities). A more rigorous effort to develop such a clear and agreed upon set of principles which rests on economic, philosophic and fairness grounds is needed.[31]

2.4 Limited Inclusiveness and Multilateralism

Global challenges need global solutions. BEPS, as a global concern, is made possible by uncoordinated tax rules at domestic and international levels. Therefore, the global solutions need to be based on inclusive and multilateral global governance. This means each and every country should be offered equal opportunity and equal weight to shape the outcome of the global solutions.[32]

Although OECD/G20 have made great efforts in organising many non-member countries and NGOs to participate in the development of the BEPS package, the inclusiveness and multilateralism of the BEPS project is limited for a number of reasons.

First, the undisputed fact is that major OECD countries dominated the formulation of the BEPS package in the process of discussions and negotiations. As OECD countries are all developed countries, it is inevitable that the BEPS project is mainly a result of compromise between the rich countries. For instance, weak measures

27. *Ibid*.
28. For a detailed exposition of the case law demonstrating this repeated failure, *see* Avi-Yonah (1995), above n. 21.
29. *See* BEPS Monitoring Group, above n. 22.
30. OECD, above n. 15, at 5.
31. M. Herzfeld, 'The Limits of Tax Coordination', *Working Draft* (11 October 2015).
32. This does not of course mean that every country will in fact participate, only that they should be given the opportunity to do so.

on CFCs, interest deductibility and innovation box schemes are favoured particularly by the UK.[33]

Second, although over 60 countries were directly involved in the process of the BEPS project, they only account for less than one-third of 193 UN members.[34] As MNEs have their taxable presence around the globe, including the non-participating countries, the effectiveness of the BEPS project is very limited. The tax competitions between participating countries and non-participating countries will continue. The race to the bottom and the unilateral actions taken by any jurisdiction could hurt all the countries in the world.

Third, although some developing countries were consulted for the BEPS project, it does not necessarily mean that their core proposals were finally accepted by the BEPS package. As observed by independent commentators, some key OECD countries opposed and succeeded in blocking the institutional reform proposal from developing countries at the 3rd International Conference on 'Financing for Development'.[35]

Fourth, less influential participating countries and more than 120 non-participating counties might be hurt due to the effect of negative spillover arising from the implementation of the BEPS project in the future. They are weak not only because of their limited influence in the renovation of the current rules, but also because of their limited experience and resources to enforce the BEPS actions.

Fifth, the process of public debate and consulting was relatively insufficient. BEPS Monitoring Group, an active tax justice advocate, complains that they have been vastly outnumbered by the army of paid tax advisers and representatives of multinational enterprises.[36] Although stakeholder interest, including invaluable interactions with business and civil society, saw more than 12,000 pages of comments received on the 23 discussion drafts published and discussed at 11 public consultations,[37] it is unknown to what extent these valuable proposals have been adopted by the BEPS package. More importantly, detailed reasons for rejecting different proposals have not been published.

Given the fact that it is impossible to guarantee that countries and stakeholders really had the equal opportunity to influence and shape the outcome of the BEPS package on really equal footing, OECD and/or G20 is not the truly global platform for comprehensive reform of international tax law. To transform the current BEPS project into truly global, coherent, coordinated and inclusive actions, the UN should undertake the leadership in the next stage of international tax law reform.

The third paragraph of Article 1 of the Charter of the UN recognises that the third purpose of the UN is to achieve international cooperation in solving international problems of an economic, social, cultural or humanitarian character. The fourth paragraph of Article 1 of the Charter of the UN recognises that its fourth purpose is to 'be a centre for harmonizing the actions of nations in the attainment of these common ends'.

We believe that the UN will be more qualified, impartial, transparent, credible and influential than the OECD/G20 in rewriting and renovating the international tax rules including the BEPS counter-measures. All UN members have the right to be heard and represented in the process of international tax law reform.[38] As the working group of the UN, the UN Tax committee is expected to make great difference in this regard.

We urge that the UN Convention of Anti-BEPS should be made the cornerstone of the global response to BEPS in a more coherent, inclusive and multilateral manner. Compared with the partial multilateral approach of OEC/G20, the global BEPS actions launched by the UN will better address the BEPS concerns and restore the integrity of international tax principles of single tax, neutrality, transparency and fairness.

3 Reconsidering the International Tax Regime: A Multilateral Solution

As stated above, in our opinion it is time to re-evaluate the benefits principle. Most of the current issues can be solved if we taxed passive income primarily at source and active income primarily at residence.

For passive income, the number of source jurisdictions is much smaller than residence jurisdictions. Because most individuals are relatively risk averse, portfolio investment flows overwhelmingly to a small number of countries – the US, the EU and Japan. If these three jurisdictions could impose a withholding tax on all outbound payments, most of the problem of taxing passive income could be resolved. Crucially, money cannot stay in tax havens and earn decent rates of return, so the cooperation of tax havens in not needed.

In the case of active income, about 90% of large multinationals are headquartered in G20 countries, and none of those countries has a corporate tax rate below 20%. If the G20 taxed their multinationals (based on where the headquarters are located) on a current basis and restricted the ability to move the headquarters, the problem of taxing active income would be largely resolved as well. This would take care of the Apple and Caterpillar problems, because all of their offshore income would be subject to current US taxation.[39]

As the first author has argued elsewhere, this multilateral approach takes care of the three common critiques of abolishing deferral of tax on active income. These critiques are based on economic neutrality, competitive-

33. The BEPS Monitoring Group, above n. 22, at 3.
34. Available at: <www.un.org/depts/dhl/unms/whatisms.shtml#states>.
35. The BEPS Monitoring Group, above n. 22.
36. *Ibid*.
37. OECD, above n. 15, at 5.
38. The UN is based on the principle of sovereign equality of all its members. *See* UN Charter.
39. Some of the BEPS action items (8-10) seek to address the types of profit shifting engaged in by Apple and Caterpillar, but as argued above they are not very effective.

ness and the risk of corporate expatriations. If all our major competitors are subject to the same regime, this resolves all three problems.[40]

But what if the other countries in the G20 are unlikely to coordinate with the US? In that case, the solution is 'constructive unilateralism': unilateral action by the US that leads to action by other jurisdictions.

The precedent is the adoption of the CFC rules, which proves (among other examples) that such action can be both possible and effective in pushing other countries to adopt similar rules.[41]

Before 1961, no country taxed the foreign source income of subsidiaries of its multinationals, because residence countries believed they lacked both source and residence jurisdiction over foreign source income of foreign corporations. However, in 1961 the Kennedy Administration proposed taxing all income of 'controlled foreign corporations' (CFCs) by using a deemed dividend mechanism that was copied from the FPHC rules.[42]

While this proposal was rejected, the resulting compromise (Subpart F, 1962) aimed at taxing income of CFCs that was unlikely to be taxed by source countries either because it was mobile and could be earned anywhere (passive income), or because it was structured to be earned in low-tax jurisdictions (base company income).

Initially, the adoption of Subpart F seemed to have put US-based multinationals at a competitive disadvantage, because no other country had such rules. But gradually this picture changed. The US was followed by Germany (1972), Canada (1975), Japan (1978), France (1980), United Kingdom (1984), New Zealand (1988), Australia (1990), Sweden (1990), Norway (1992), Denmark (1995), Finland (1995), Indonesia (1995), Portugal (1995), Spain (1995), Hungary (1997), Mexico (1997), South Africa (1997), South Korea (1997), Argentina (1999), Brazil (2000), Italy (2000), Estonia (2000), Israel (2003), Turkey (2006), and China (2008). Many other countries, such as India, are considering adopting such rules. As a result, most of our trading partners now have CFC rules.

Moreover, the later adopters improved on the US in two principal ways. First, they rejected the deemed dividend mechanism, which can lead to many unforeseen complications, in favour of taxing the shareholders on a pass-through basis. Second, they generally explicitly incorporate the effective foreign tax rate into the determination whether a CFC will be subject to current tax. This is better than the US rule that is based solely on the type of income, because after 1980 it became quite easy to earn active income that is not subject to tax.[43]

The result is that the CFCs of EU-based multinationals are currently generally subject to tax at similar or higher rates than US-based ones,[44] despite the non-taxation of dividends from active income under territoriality. This is therefore a classic example of constructive unilateralism. The US led and others followed, and the end result is that most multinationals are subject to similar effective tax rates, with no competitive disadvantage or advantage.[45] The result is a world in which there is much less double non-taxation than in the absence of CFC rules.

Unfortunately, in the US Subpart F has been critically undermined by the adoption of check the box and the CFC to CFC exception, resulting in $2 trillion of low-taxed accumulated earnings offshore by US multinationals.[46] This cannot happen in other countries with tougher CFC rules, and is a major part of the explanation why despite rampant tax competition most OECD members did not see the sharp drops in overall corporate tax revenues that are seen in developing countries.

The main argument in favour of territoriality (i.e. exempting dividends paid by US CFCs from tax upon receipt by their parents) is the lock-out problem. About $2 trillion in low-taxed foreign source income are in CFCs that cannot repatriate them because of the 35% tax on repatriations and the absence of foreign tax credits.[47] We know this is a real problem because of the effectiveness of the 2004-2005 amnesty and because of various attempts by multinationals to avoid the rule (e.g. via inversions, 'killer Bs', short-term loans, etc.).[48]

But it is less clear that the solution is a participation exemption. Why not abolish deferral and let the dividends flow back tax-free?

We would argue that this is a good opportunity for 'constructive unilateralism'. No G20 country has a corporate tax rate below 20%. If the US reduced the corporate tax to, say, 28%, and at the same time abolished deferral, the likely response by other G20 members like Germany or France would be to follow suit.[49] They need the extra revenue more than we do, and concerns about competitiveness would be alleviated by the US move, like they were in the original CFC context.

It should be remembered that the other G20 have more effective CFC rules than we do, and those CFC rules already act as a de facto worldwide system with a mini-

40. R. Avi-Yonah, 'Hanging Together: A Multilateral Approach to Taxing Multinationals', in T. Pogge and K. Mehta (eds.), *Global Tax Fairness*, (2016) at 113.
41. We do not think unilateral action is possible on the evasion front, but as explained above, coordinated withholding taxes by the US and the EU should work.
42. R. Avi-Yonah, 'The Deemed Dividend Problem', 4 *J. Tax. Glob. Trans*. 33 (2004), also in Proceedings of the National Tax Assoc. Annual Meeting (2004).
43. *See* Avi-Yonah (2000), above n. 2.
44. *See* R.S. Avi-Yonah and Y. Lahav, 'The Effective Tax Rate of the Largest US and EU Multinationals' (October 25, 2011), U of Michigan Law & Econ, Empirical Legal Studies Center Paper No. 11-015; U of Michigan Public Law Working Paper No. 255. Available at SSRN: <https://ssrn.com/abstract=1949226> or <http://dx.doi.org/10.2139/ssrn.1949226>.
45. *Ibid*.
46. K.A. Clausing, 'The Effect of Profit Shifting on the Corporate Tax Base', *Tax Notes*, 25 January 2016.
47. *Ibid*.
48. US Senate PSI, <RepatriatingOffshoreFundsReportOct202011wExhibitsFINAL.pdf>.
49. 28% is the rate at which a revenue neutral corporate tax reform can be achieved if we abolished the three major corporate tax expenditures (deferral, accelerated depreciation and the domestic manufacturing deduction). Available at: <https://www.fas.org/sgp/crs/misc/R44220.pdf>.

mum tax: If the foreign tax is below a set level (e.g. 25% in Germany or 20% in Japan), the CFC rules kick in to tax the income. The result is that there is much less lock out because most low-taxed foreign income is taxed by the CFC rules. The change to a worldwide system would be much less radical than usually envisaged. This is why for both the UK and Japan there was no significant increase in repatriations after they adopted territoriality in 2009.[50]

But should the US not adopt a minimum but lower tax on foreign source income for competitiveness reasons? This is what both the Obama and Camp proposals envisage. Obama suggests a 28% corporate tax on domestic profits and a 19% tax on foreign income, while Camp proposed a 25% tax on domestic profits and a 12.5-15% tax on foreign income.

The problem, of course, is that such a gap would still encourage US-based MNEs to shift profits overseas, with no repatriation tax to deter them. We can always fall back to such a system if needed. But for now we would suggest taxing all income at the same rate, and if that rate has to be lower, so be it. As long as it is above 20% we do not think we will be outside G20 norms, and a rate in the 20-25% range will not put our MNEs at a significant competitive disadvantage given the effective minimum tax imposed by the CFC rules of our trading partners.

It is impossible to predict what will happen, but the history described above suggests that there is a good chance that other G20 countries will follow us if we abolish deferral at a lower rate.[51] And if that happens, all the usual objections to worldwide taxation (competitiveness, inversions and the various neutralities) lose their force. We do not think there is a significant risk involved in this move, and the potential upside is quite large.

4 Conclusion

The benefits principle should be reconsidered in light of the reality of globalisation. We should tax passive income primarily at source and active income primarily at residence. This will enable the large economies to address both individual tax evasion and corporate tax avoidance.

These problems must be addressed if we are to continue to maintain and expand the benefits of globalisation. The US public support of globalisation hinges on the existence of a social insurance safety net. If the rich and large corporations are not perceived to pay their fair share, the public's willingness to pay tax to support this safety net is eroded. Once a culture of not paying taxes is established, it is very hard to change. We need to do something about both tax evasion and avoidance before it is too late.

50. S.E. Shay, J.C. Fleming & R.J. Peroni, 'Territoriality in Search of Principles and Revenue: Camp and Enzi', 141 *Tax Notes* 173 (2013); 72 *Tax Notes Int.* 155 (2013). Available at SSRN: <http://ssrn.com/abstract=2340615>.

51. *See* the most recent proposal of the EU Commission to tax currently CFC profits that are subject to an effective tax rate below 40% of the residence country rate if over 50% of the CFC's income is either passive or derived from sales to related parties. Council of the European Union Doc. 14544/15 (2 December 2015) and Doc.14544/15 Add 1 (2 December 2015), Art. 9. *See also* EU Commission, 'Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market', *COM* (2016) 26 final; EU Commission, 'Anti Tax Avoidance Package', *COM* (2016) 23 final. But *see* 'US blasts Brussels over tax probe bias', *Financial Times*, 29 January 2016. Hopefully the next US Administration will take a more cooperative attitude.

The Integrity of the Tax System after BEPS: A Shared Responsibility

Hans Gribnau*

Abstract

The international tax system is the result of the interaction of different actors who share the responsibility for its integrity. States and multinational corporations both enjoy to a certain extent freedom of choice with regard to their tax behaviour – which entails moral responsibility. Making, interpreting and using tax rules therefore is inevitably a matter of exercising responsibility. Both should abstain from viewing tax laws as a bunch of technical rules to be used as a tool without any intrinsic moral or legal value. States bear primary responsibility for the integrity of the international tax system. They should become more reticent in their use of tax as regulatory instrument – competing with one another for multinationals' investment. They should also act more responsibly by cooperating to make better rules to prevent aggressive tax planning, which entails a shift in tax payments from very expert taxpayers to other taxpayers. Here, the distributive justice of the tax system and a level playing field should be guaranteed. Multinationals should abstain from putting pressure on states and lobbying for favourable tax rules that disproportionally affect other taxpayers – SMEs and individual taxpayers alike. Multinationals and their tax advisers should avoid irresponsible conduct by not aiming to pay a minimalist amount of (corporate income) taxes – merely staying within the boundaries of the letter of the law. Especially CSR-corporations should assume the responsibility for the integrity of the tax system.

Keywords: flawed legislation, tax privileges, tax planning, corporate social responsibility, tax professionals

1 Introduction

In recent years international tax law has become a hotly disputed topic. The public outcry over the aggressive tax planning practices of multinational enterprises and the lack of effective rules and cooperation between states to counter these practices with fair and effective rules shows deep concerns about the integrity of the international tax system. Rebuilding public trust in the integrity of the tax system has thus become an urgent matter.

OECD's Base Erosion and Profit Shifting (BEPS) Project proposes improvements in order to ensure more responsible fiscal behaviour of both governments and multinationals to bring the eroding of the integrity of the (international) tax system to a halt.

BEPS aims at improving the integrity of the internal tax system. This integrity has been hollowed out by both multinationals and states. On the one hand, multinationals gaming the tax system, minimising their tax liability, erode this integrity. They do not pay their share though everyone, both citizens and companies, should contribute to the financing of public expenditure everyone benefits from. On the other hand, the rules of the game are set by countries competing for multinationals' investment by lowering corporate tax costs. Both multinationals and states compete at an international level.

Who is to be held responsible for the erosions of the tax system? Multinationals or states? This is the question to be answered in this article. It is a moral question for taxation is a moral phenomenon, as will be argued. Both actors probably interact. Of course, other actors play a role as well. Thus, the integrity of the tax system may appear to be a shared responsibility, but, if so, are these actors equally responsible?

The societal relevance of this issue is out of question. Taxes are the main funding for society and for individual liberty to flourish. Moreover, they are an important means to enhance distributive justice. But the issue at stake is also of theoretical relevance. Tax theory does not provide yet a detailed and balanced view on the question of moral responsibility.

As for methodology, the research question calls for an interdisciplinary approach. This article places itself at the intersection of tax law, fiscal sociology, (business) ethics, economics and legal philosophy. Academic literature is the primary source but incidentally reference will also be made to reports and non-academic articles.

This article is structured as follows. First the concept of responsibility will be applied in tax context. It will appear that both states and multinationals, and their advisers, make choices that affect the international tax system. Freedom of choice, however, entails moral responsibility. They are therefore both responsible for the integrity of the tax system – although states are primarily responsible. Then the behaviour of states and multinational corporations will be evaluated from this perspective on responsibility. States should in a cooperative effort improve the tax system. Companies endorsing corporate social responsibility, and their tax advisers, should avoid acting irresponsibly and therefore not

* Professor of Tax Law, Fiscal Institute and the Center for Company Law, Tilburg University; Professor of Tax Law, Leiden University, The Netherlands.

engage in aggressive tax planning. The argument will be wrapped up in a conclusion.

2 Integer Taxation: A Shared Responsibility

2.1 Introduction

The public outcry over aggressive tax planning and the failure of the international tax system regards the distribution of the tax burden over members of society. Many (corporate) taxpayers command the kind of resources that enable them to plan their taxes in a very sophisticated and successful manner – they pay hardly any (income) taxes at all, thus shifting the tax burden to less expert taxpayers. The tax rules put in place by states are apparently unable to prevent this kind of behaviour. Thus one of the fundamental principles of the tax system, i.e. distributive justice, is seriously impaired. The notion of distributive justice entails that society is seen as responsible for the condition of the less well of and capable of changing it. Distributive justice calls on the state – as an intermediary – to guarantee that 'everyone is supplied with a certain level of material means.'[1] The tax system serves distributive justice. According to the legal philosopher Dworkin the ideal of integrity in law requires a commitment to a coherent set of principles, 'the promise that law will be chosen, changed and developed and interpreted in an overall principled way'.[2] This also goes for tax law, which therefore should meet the requirement of principled consistency.[3] Unfortunately, it does not, for both legal principles and non-legal principles are often seriously neglected. No wonder, trust in the integrity of the tax system, governments and multinationals is under pressure. This illustrates the foundational nature of tax.

Taxes are paid for the government to secure the functioning of the market and achieve various public goods and services sustaining society. They are payments to the state on behalf of society. Indeed as Thomas Piketty writes: 'Without taxes, society has no common destiny, and collective action is impossible.'[4] Thus taxation is a moral phenomenon.[5] There are other dimensions, of course, be it economic, legal, political or democratic, to name some, but the moral dimension cannot be dispensed with. Therefore, the behaviour of the law-making and law-applying institutions – legislature, tax administration and courts – that are involved in taxation affects the moral dimension. These actors are responsible for the design and actual workings of the tax system. Their behaviour needs ethical evaluation. The same seems to go for the behaviour of (corporate) taxpayers. Tax evasion and aggressive tax planning entail evidently not contributing a fair share to society. This suggests that the issue of responsibility is at stake.

The integrity of tax law and tax systems is thus of great importance to society. Law makers should therefore act responsibly with regard to tax law. Responsible law making entails adequate rules. As Fuller argues, there must be rules in order to guide human conduct. This minimal requirement of the 'generality of law is a bulwark against arbitrariness'.[6] The legislature, however, should strive for more than a minimum level of legality. As Machiavelli maintained, laws can man make good (though not perfect).[7] Skinner comments on this famous idea: 'the law can be used to force us out of our habitual patterns of self-interested behaviour, to force us into the full range of our civic duties'.[8] An integer system of tax laws thus makes people behave better than a system seriously lacking in fairness. However, there may be other actors bearing responsibility for international tax law, for corporations' behaviour affect the tax burden of other taxpayers. This raises the question whether there is room for responsibility with regard to this (indirect) interaction with other taxpayers. Note that states by way of taxation determine what citizens have to contribute to the resources needed to sustain society, that is, what they owe to their fellow citizens.

In this context, responsibility is a moral rather than a legal concept. First, the relationship between law and morality has therefore to be explored. Second, the concept of 'moral responsibility' should be elucidated – and its relationship with freedom.

2.2 Law and Morality

The legal system is distinguished from ethics. The legal system can be seen as a formal public system containing norms regulating (corporate) citizens' behaviour; it governs behaviour affecting other persons.[9] Like the legal system, morality regulates individuals' behaviour, it addresses not only the question as to how one ought to live as an individual, but also how individuals should interact with other individuals. Morality is also a public system, in the sense that there is shared understanding

1. S. Fleischacker, *A Short History of Distributive Justice*, Cambridge (MA) / London: Harvard University Press (2004), at 4.
2. R. Dworkin, *Law's Empire*, Cambridge (MA) / London: Harvard University Press (1986), at 300-1.
3. Cf. E.J. McCaffery, 'Tax's Empire', 85 *The Georgetown Law Journal* (1996), at 107.
4. T. Piketty, *Capital in the Twenty-First Century*, Cambridge (MA) / London: The Belknap Press of Harvard University Press (2014), at 493.
5. P. Sloterdijk, *Die nehmende Hand und die gebende Seite*, Berlin: Suhrkamp Verlag (2010). One of the interviews in the book (at 141-5) is titled 'Steuern sind das zentrale moralische Phänomen unserer Zivilisation.' Cf. J.L.M. Gribnau, 'Voluntary Compliance Beyond the Letter of the Law: Reciprocity and Fair Play', in B. Peeters, J.L.M. Gribnau & J. Badisco (eds.), *Building Trust in Taxation*, Cambridge: Intersentia (2017).
6. L.L. Fuller, *The Morality of Law* [1964], New Haven (CT) / London: Yale University Press (1977), at 46-9.
7. N. Machiavelli, *Discourses on Livy*, Chicago / London: Chicago University Press (1996), I.iii, at 15.
8. Q. Skinner, 'The Republican Ideal of Political Liberty', in G. Bock, Q. Skinner & M. Viroli (eds.), *Machiavelli and Republicanism*, Cambridge: Cambridge University Press (1990), at 305.
9. The legal philosopher Hart called these rules 'primary rules of obligation'. A system of laws consists also of so-called secondary rules that provide for the authoritative recognition of legal rules and for changing the rules, and adjudicating 'disputes as to whether an admitted rule has or has not been violated'; H.L.A. Hart, *The Concept of Law*, Oxford: Oxford University Press (2012), at 93.

and knowledge about how one should act, and that it is not irrational to be guided and judged by that common morality. This informal public system includes moral rules, principles, values, ideals and virtues, which, however, may entail conflicting and competing demands. Unlike the legal system, morality is an informal public system. There are no judges who have the authority to decide on moral conflicts nor formal decision procedures that provide unique and definite answers to all moral questions.[10] Therefore, though law is one thing, and ethics another, they are connected.

The tax rules should grosso modo reflect public morality, but there is no identicalness between the two. The legal system will never be able to exhaustively codify public morality – neither should it strive for that. Ethical responsibilities are thus not exhaustively codified in the law. The same goes for the tax rules, which have to reflect by and large the prevailing views (public morality) with regard to the fair distribution of the tax burden and the ways tax can be used to enhance the lives of the members of society. These legal rules should also be established and applied in conformity with fundamental legal values – which reflect important social and moral values.

Legal responsibilities reflect a view of 'codified ethics' in the sense that they embody basic notions of fair practices as established by law makers.[11] The difference between the existing tax system and morality opens a space that offers many possibilities for action. Thus the actors involved in the tax system enjoy a certain freedom of choice with regard to the design, interpretation, application and use of tax rules. The choices may affect, enhance or undermine the integrity of the tax system vital for a viable society. This means that moral responsibility begins where actions are not completely determined by the tax law, which is often the case, for freedom entails responsibility – taxation being a moral phenomenon.

2.3 Freedom and Responsibility

Freedom and responsibility are interdependent. Persons are morally responsible for harms (including unjust benefits) they cause, which are seen as blameworthy, or morally faulty. The wrongdoing causes people to respond negatively. When a rational person could have avoided the blameworthy result by making an appropriate choice, this makes him or her responsible. Thus as Lucas states, responsibility presupposes 'that there are agents, that agents act for reasons, and that it is up to an agent whether he acts or not.'[12] Persons may lack the particular knowledge requisite for doing otherwise, and, therefore, for being responsible.

Besides this 'cognitive condition', one may discern the 'freedom-relevant condition', for moral responsibility 'requires the freedom to pursue alternative courses of action.'[13] Not being in control over an action excuses the person. Moral responsibility presupposes a choice between two events, both of which one has the power to bring freely about. Freedom and capability are necessary for responsibility. 'But actually having the freedom and capability to do something does impose on the person the duty to consider whether or not to do it, and this does involve personal responsibility.'[14] Responsible behaviour then is behaviour that takes into account the interests of others trying to avoid bringing (disproportionate) harm to others. Clearly, without any reasonable excuse disproportionately impacting or violating the interests of others amounts to irresponsible behaviour. To my mind, there is a bandwidth between perfectly responsible behaviour and clearly irresponsible behaviour. Reasonable people may disagree on the qualification of behaviour within a certain range. However, there will be a general consensus that behaviour crossing a certain lower limit must be qualified as irresponsible. This is for example the case when a company's aggressive tax strategy policy is completely disembedded from the general business strategy, turning the tax department into a profit centre.

Are multinational corporations different from individuals in this respect? In other words, is responsibility restricted to human being rather than legal actors? I will come back to this question in Section 5.

2.4 Tax: Shared Responsibility

This idea of moral responsibility can be applied to fiscal actors. Legislatures have a certain freedom to choose for which policies they want to use the tax system. They make up their minds in a deliberative process. Of course, they should not violate human rights and respect international treaties. However, in many areas they enjoy much freedom to design the tax system according to their (policy) ends. The European Court of Justice, for example, leaves legislatures a wide margin of appreciation when testing (technical aspects of) tax statutes against the principle of equality.[15] Tax legislation leaves tax administrations a certain freedom. Tax administrations face choices when interpreting the tax law and enjoy discretion with regard to the way the tax law is enforced.[16] The same goes – mutatis mutandis – for tax courts supervising the tax administrations and checking the legislative power. With regard to (corporate) taxpay-

10. Cf. B. Gert, *Morality: Its Nature and Justification*, Oxford: Oxford University Press (1998), at 11. Cf. J.L.M. Gribnau and A.-G. Jallai, 'Good Tax Governance and Transparency: A Matter of Ethical Motivation', *TLS Working Paper*, 18 May 2016: 2-3.
11. A.B. Carroll, 'The Pyramid of Corporate Social Responsibility: Toward the Moral Management of Organizational Stakeholders', *Business Horizons* (July-August 1991) 39-48, at 41.
12. J.R. Lucas, *Responsibility*, Oxford: Oxford University Press (1993), at 12.
13. J.M. Fischer and M. Ravizza (ed.), *Perspectives on Moral Responsibility*, Ithaca (NY): Cornell University Press (1993), at 8.
14. A. Sen, *Development as Freedom*, New York (NY): Alfred A. Knopf (2000), at 284.
15. ECtHR 22 June 1999, Appl. No. 46757/99, *Della Ciaja/Italy*, BNB 2002/398, Cf. J.L.M. Gribnau, 'Equality, Legal Certainty and Tax Legislation in the Netherlands: Fundamental Legal Principles as Checks on Legislative Power: A Case Study', 9 *Utrecht Law Review* 2 (2013), at 64; <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2244793>.
16. Cf. H. Gribnau, 'Horizontal Monitoring: Some Procedural Tax Law Issues', in R. Russo (ed.), *Tax Assurance*, Deventer: Kluwer (2015), at 194-5.

ers, as stated earlier, tax rules are in many ways indeterminate and therefore a matter of choice within the boundaries of the law (see Section 6.5). Especially multinational corporations enjoy much freedom in this respect. The behaviour of all these actors has an impact on the financial resources of the state sustaining society and the way in which the tax burden is spread over the citizens (distributive justice).

All these actors, legislatures, courts, tax administrations and taxpayers, enjoy a degree of freedom and thus can be held responsible for the integrity of the tax system. This integrity is a matter of shared responsibility. Of course, the primary responsibility lies with the state(s), i.e. the legislature(s), for in a democratic state the legislature represents the people, thus being authorised to set the rules of the game. Their responsibility is to establish fair and effective legislation. It is up to the tax authorities to apply and enforce the tax rules set by the legislature. The courts provide legal protection to taxpayers in case of tax disputes – an essential part of any integer tax system. And last but not least, taxpayers bear responsibility for integrity of their tax systems. If they evade or completely minimise their tax payments, government would lack the financial means essential to sustaining society and thus society would be at risk. Though the law should be equally applied to all; some taxpayers manage to escape their obligations by searching every nook and cranny of the tax system. Thus, for some (corporate) taxpayers to pay taxes becomes a matter of choice. This may have dire consequences, as Williams observes: 'If the system is seen by the general populace as to some extent optional, and open to "abuse" by those who can afford to pay for sophisticated tax advice, then this may engender social discord and discourage compliance by other taxpayers.'[17]

To conclude, the integrity of the tax system is a matter of shared responsibility, even though it is asymmetric. The fact that the legislature has to advance the general interest, whereas taxpayers may advance their own interests, accounts for this normative asymmetry. In the following sections, I will deal with the way tax legislature(s) and (corporate) taxpayers – and their tax advisers – handle their responsibility for the integrity of the tax system.

3 States and Their Responsibility

3.1 Introduction

As stated earlier, the legislature had the primary responsibility to establish a fair and effective system of taxation. The legislature sets out the total amount of tax to be paid by the members of society, and allocates the payments to the members of society. Hence, the legislature must determine the fair share taxpayers have to contribute. However, once the legislature has created this legal obligation and translated in legal written rules, the rules will inevitably appear to be imperfect, ambiguous, lagging behind societal, economic and technical developments and taxpayers' undesirable use of legislation,[18] and so on. The letter of the law may diverge from the spirit of the law.[19] The legislature, of course, has the primary responsibility for narrowing the gap between the letter of the law and the spirit of the law. With regard to the international taxation, states should cooperate to restore the integrity of the international tax system.[20]

Tax legislation should be based on an impartial balancing of the different interests involved. The legislative process should be transparent and unbiased. Interests-groups lobbying for favourable tax rules are influential actors in the decision-making process. Corporate lobbying is often very effective, which may result in tax privileges at the expense of other taxpayers. The prevailing political view on taxation as a regulatory tool, to realise all kind of policy goals, increases the risk of the introduction of privileges – to the prejudice of the integrity of the tax system. The tax system thus stimulates the adoption of a calculating attitude in which rules are seen as opportunities to pay less tax. An ethical attitude, which sees paying tax as contributing to the sustenance of society in a fair way shared by all, is crowded out.

States also use tax vying with each other for investments that companies make within their jurisdiction. They expect that these investments will generate employment and tax revenues.[21] Tax competition has become part and parcel of this regulatory competition. Governments competing for investment take into account the interests of multinational corporations (MNCs) trying to meet their demand for favourable tax rules. Harmful competition results in very favourable tax regimes for corporate taxpayers – shifting the tax burden to other taxpayers. Again a rule-focus is created: tax rules are seen as instruments to lower corporation' tax liability. With regard to international taxation, states should therefore

17. D.F. Williams, *Tax and Corporate Social Responsibility* (2007), at 4; <www.kpmg.co.uk/pubs/Tax_and_CSR_Final.pdf>.

18. Cf. OECD, *Study into the Role of Tax Intermediaries*, Paris: OECD (2008), at 87: 'the often lengthy period between the time schemes are created and sold and the time revenue bodies discover them and remedial legislation is enacted.'

19. Here I use the term 'letter of the law' as shorthand with regard to tax planning that exploits the technicalities or differences between tax systems by making use of 'a bewildering variety of techniques (*e.g.* multiple deductions of the same loss, double-dip leases, mismatch arrangements, loss-making financial assets artificially allocated to high-tax jurisdictions)'; P. Piantavigna, 'Tax Abuse and Aggressive Tax Planning in the BEPS Era: How EU Law and the OECD Are Establishing a Unifying Conceptual Framework in International Tax Law, Despite Linguistic Discrepancies', 9 *World Tax Journal* 1 (2017), 47-98, at 52.

20. Cf. J. Freedman, 'The Tax Avoidance Culture: Who is Responsible? Governmental Influences and Corporate Social Responsibility', in J. Holder and C. O'Cinneide (eds.), *Current Legal Problems*, New York (NY): Oxford University Press (2006), at 387: 'Government has a responsibility to create the right conditions and culture for a generally tax-compliant system which would benefit the entire legitimate business community in keeping costs down and spreading tax burdens fairly.'

21. Cf. M. Koenig-Archibugi, 'Global Regulation', in R. Baldwin, M. Cave & M. Lodge (eds.), *The Oxford Handbook of Regulation*, Oxford: Oxford University Press (2010), at 413-16.

cooperate to restore the integrity of the international tax system.

3.2 Tax Legislation Too Responsive to Business Interests

3.2.1 Tax Lobbying

Legislative decision-making requires a non-partisan and impartial attitude on the part of the legislatures. Competing interests should therefore be balanced in a reasonable way in order to uphold the integrity of the tax system. However, often, the legislature is too responsive to private or interest-group pressure resulting in legislation lacking impartiality.[22]

This already was one of Adam Smith's concerns: 'The cruellest of our revenue laws, I will venture to affirm, are mild and gentle, in comparison of some of those which the clamour of our merchants and manufacturers has extorted from the legislature.'[23] The economist Walter Bagehot elucidated this concern at the centenary of Adam Smith's *The Wealth of Nations*. The European governments of the time consulted producers. 'But, unhappily, the producer was just the wrong person to consult. What he wanted was a high price for his article, and a monopoly of the market in which to sell it, and the laws he recommended were inevitably framed, more or less, to obtain his wishes.' Consequently, these laws worked badly, because they were framed in the wrong person's interest. In this way, 'the cat had the custody of the cream.'[24]

Consultation is one thing, (actively) lobbying another. Lobbying is the presentation of group's point of view and usually aimed at getting the group's perspective across the legislators and influencing legislative decisions, i.e. to vote their way. They can play a positive role by supplying information to the legislators who then have to assess the credibility of information and cross-check it with information supplied by other lobbyists or interest groups. 'Lobbyists provide policymakers with research, draft-legislation and pass up-to-the-minute information.'[25] By way of lobbying corporations participate in the public policy making process. This kind of corporate political activity is part of the democratic 'engagement of individuals – and groups of individuals such as corporations – in the full and free expression of their views on matters of public policy'.[26] Lobbyists induce public officials and legislators to adopt a particular position on an issue that benefits business. Business lobbyists will also try to draft legislation containing tax breaks, tax incentives and the like. However, everyday lobbying methods may amount to 'pressure tactics'.[27]

Thus, the democratic legitimacy of tax laws is at risk, for as Piketty argues: 'No one has the right to set his own tax rates.'[28] Influential interest groups, however, may hijack the legislative process to advance their own interests at the expense the general interest. Powerful lobbies may obtain privileges to the detriment of the integrity of the tax system.

3.2.2 The Visible Hand and Corporate Tax Privileges

Corporations are among the most influential lobbyists. Asymmetry of money and expertise enables business lobbyists to influence much of the legislative agenda. Political philosopher Wolin even argues that 'in matters of public policy and governmental decision-making, (corporate) lobbying demonstrates how little the actions of the electorate matter'.[29] The notion that business and government are partners, sharing the same mission, threatens governments' sovereignty over corporations for the latter 'stand next to, rather than under democratic governments'.[30] Just as Adam Smith warned that consultation may result in laws working ill, lobbying by the

22. Tax advisors and their professional organisations often advise the legislature on technical issues in drafting legislation. According to the UK Public Accounts Committee this may give rise 'to a perception that they have an influence on the formulation of tax policy that smaller businesses do not have.' Though this assistance may improve the quality of tax legislation, the Committee is 'concerned that the very people who provide this advice then go on to advise their clients how to use those laws to avoid tax; The (UK) House of Commons, Committee of Public Accounts, *Tax Avoidance: The Role of Large Accountancy Firms*, Forty-fourth Report of Session 2012-13 Report, together with formal minutes, oral and written evidence, London: The Stationery Office Limited (2013), at 5.
23. A. Smith, *An Inquiry in the Nature and Causes of the Wealth of Nations* [1776], Indianapolis (IN): Liberty Fund (1981) IV.viii.4, at 648. Cf. A. Smith, *Lectures on Jurisprudence*, Indianapolis (IN): Liberty Fund (1982), at 529.
24. R. Dudley Edwards (ed.), *The Best of Bagehot*, London: Hamish Hamilton (1993), at 37-8.
25. J. Madrick, 'How the Lobbyists Win in Washington', *New York Review of Books* (7 April 2016), at 50. He quotes Hall and Deardorff: 'Legislators…work hard primarily on behalf of the interests that can afford the high costs, not only of organizing and making campaign contributions, but of paying professional lobbyists and financing the organizations that support them.'
26. A. Stark, 'Business in Politics: Lobbying and Corporate Campaign Contributions', in G.G. Brenkert and T.L. Beauchamp (eds.), *The Oxford Handbook of Business Ethics*, Oxford: Oxford University Press (2009), at 501. Stark discusses the conflict between two ethical principles which should govern corporate political activity: government in which public officials are free from corruption, on the one hand, and robust political engagement of individuals and organisations, on the other.
27. W.N. Eskridge, P.P. Frickey & E. Garrett, *Legislation: Statutes and the Creation of Public Policy*, St. Paul (MN): West Publishing Company (2001), at 285-7. Cf. the warning issued by the Business Roundtable on behalf of 185 chief executives that the EU and its people risk a 'grievous self-inflicted wound' after the European Commission's ruling that Apple must pay back Ireland €13bn in taxes <http://businessroundtable.org/resources/business-roundtable-letter-eu-heads-state-or-government-regarding-state-aid-investigations>; *see* 'Apple tax ruling must be overturned, says US business group', *The Guardian*, 16 September 2016. A. Christians, 'Friends with Tax Benefits: Apple's Cautionary Tale', 78 *Tax Notes International* (2015) 11 argues that this 'fiscal state aid' ruling 'is fundamentally an interrogation into what, if anything, governments can or should do to stop the strategic use of national tax systems to lure international trade and investment.'
28. Piketty, above n. 4, at 522.
29. S.S. Wolin, *Democracy Incorporated: Managed Democracy and the Specter of Inverted Totalitarianism*, Princeton (NJ) / Oxford: Princeton University Press (2008), at 194.
30. J. Bakan, *The Corporation: The Pathological Pursuit of Power*, London: Constable (2005), at 108.

modern globalising corporation will result in laws 'inevitably framed, more or less, to obtain his wishes'. As a result it is not the 'invisible hand' that guides the individual selfish actor 'to promote an end which was no part of his intention', as Adam Smith might seem to suggest.[31] On the contrary, it is the state's hand very effectively guided by corporate lobbying. In both international and national settings, business can thus 'influence both the substance of law and how it is enforced through lobbying and negotiating, introducing compromise and weakening control'.[32] Pressure from business (and wealthy citizens) and international (tax) competition has placed pressure on public services and governments' capacity to regulate business activities.[33] Moreover, large corporations are often able to outsource risks as for example state support of banks in the wake of the financial crisis has shown. This boils down to corporations 'demanding the socialization of their risks, so that public taxpayers can pay the costs of their business fiascos'.[34]

The serious effects on society of corporate lobbying and shaping government policy builds on the fact that most Western states use their extensive powers to promote and protect people's welfare.[35] Indeed, government does more than creating trust on which market transactions depend by legal enforcement of contracts and (intellectual) property rights. The state is not merely fixing market failures – reigning monopolies, subsidising public goods, taxing negative externalities (through investment in education and infrastructure), etc. – so as to enable market forces to efficiently allocate resources. The state does even more than playing an active role in managing markets. The 'state's very visible hand' takes on risk, shaping and creating new markets, as the economist Mazzucato maintains, 'the state is a lead risk taker and market shaper'.[36] She shows for example that without decades of research efforts and funding support of the federal government, there would not have products like the iPad and iPhone. 'Apple has mastered designing and engineering technologies that were first developed and funded by the U.S. government and military.'[37] Of course, the state is expected to receive a return on investments by taxing the resulting profits. However, corporations' aggressive tax planning frustrates this expectation.

The active role of the state, guided by corporate lobbying, includes legislating generous tax incentives, for example to foster innovation (R&D). Business lobbying for creating and preserving expenditures in the form of tax exemptions is often very effective. As a result, 'the actual hand of government distributes corporate subsidies, tax breaks and the like'.[38] These tax privileges are the result of unchecked political bargaining power. Hence, as Wolin argues: 'Arguments about taxation are, at bottom, arguments about the distribution of power.'[39] Consequently, lobbying erodes a level playing field, a necessary condition for fair competition. Hence, such tax privileges (tax breaks) are sometimes introduced that violate the principle of equality. These kinds of privileges, which are obvious violations of the impartiality requirement, can be labelled 'naked preferences': the distribution of resources or opportunities to one group rather than to another solely on the ground that 'those favored have exercised the raw political power to obtain what they want'.[40] This lack of legislative impartiality goes at the cost of the principle of equality.

In short, tax policy appears to respond primarily to those with the resources to influence the policy makers. This applies to political decision-making with regard to taxation at a domestic as well as an international level. Critical scholars such as Christians argue that the system becomes increasingly unresponsive to legitimate policy goals and increasingly out of touch with justice. 'Special interests consistently exert influence on tax policy discourse through their advisors and within a broad

31. Smith (1981), above n. 23, I, ii,12, at 26-7 and IV, ii,9, at 456 and A. Smith, *The Theory of Moral Sentiments* [1759], Indianapolis (IN): Liberty Fund (1976), IV.i.10, at 184-5. The metaphor of the invisible hand reflects the idea of providence as a secular translation of God's will; N.O. Keohane, *Philosophy and the State in France: The Renaissance to the Enlightenment*, Princeton (NJ): Princeton University Press (1980), at 354.
32. D.J. McBarnet, 'Corporate Social Responsibility Beyond Law, Through Law, For Law: The New Corporate Accountability', in D.J. McBarnet, A. Voiculescu & T. Campbell (eds.), *The New Corporate Accountability: Corporate Social Responsibility and the Law*, Cambridge: Cambridge University Press (2007), at 45.
33. D. Tapscott and D. Ticoll, *The Naked Corporation: How the Age of Transparency Will Revolutionize Business*, Toronto: Penguin Canada (2004), at 184. Thus 'many governments have willingly ceded power to free markets.'
34. B. Barber, *Jihad vs McWorld: How Globalism and Tribalism are Reshaping the World*, New York (NY): Ballantine Books (1996), at 28.
35. This goes also for the United States, often represented as a country with a history of minimum government. This however, 'requires considerable imagination'; J. Gray, *False Dawn: The Delusions of Global Capitalism*, London: Granta (1998), at 105. S. Pincus, *The Heart of the Declaration: The Founders' Case for an Activist Government*, New Haven (CT) / London: Yale University Press (2016), argues that the authors of the American Declaration of Independence already advocated a political programme for state-driven economic and social development. The Declaration was 'a call for the creation of a powerful state that would actively promote the welfare of the people' (at 134) – paid for by high (progressive) taxes.
36. M. Mazzucato, *The Entrepreneurial State: Debunking Public vs. Private Sector Myths*, New York (NY): Public Affairs Books (2015), at 17.
37. Mazzucato, above n. 36, at 99.
38. Wolin, above n. 29, at 123. Cf. R.R. Reich, *Supercapitalism. The Transformation of Business, Democracy, and Everyday Life*, New York (NY): Knopf (2007), at 207: 'regulations, subsidies, and tax breaks are justified as being in the "public interest" but are most often the products of fierce lobbying by businesses or industries seeking competitive advantage over one another.'
39. Wolin, above n. 29, at 56. For the influence of Labour-party donors and business owners on Labour's policy with regard to tax breaks, *see* R. Brooks, *The Great Tax Robbery: How Britain Became a Tax Haven for Fat Cats and Big Business*, London: Oneworld Publications (2013), at 165-6.
40. C.R. Sunstein, *The Partial Constitution*, Cambridge (MA) / London: Harvard University Press (1993), at 25 and 'Equality, Consistency, and Impartiality in Tax Legislation', in J.L.M. Gribnau (ed.), *Legal Protection against Discriminatory Tax Legislation*, The Hague [etc.]: Kluwer Law International (2003), at 7-32.

spectrum of discrete and pooled capacities.'[41] Christians argues that this is a governance problem, which must systematically be addressed in order to restore taxpayer trust. To her, transparency and accountability in policy making are part of the solution.

3.3 Tax Reduced to Regulatory Instrument

The primary function of taxation is to raise revenue for necessary governmental functions, such as the provision of public goods and services enabling society and markets to flourish. Second, there is the redistributive function, which is aimed at reducing the unequal distribution of income and wealth in order to enhance distributive justice. However, these two functions seem to be overshadowed by the instrumental or regulatory function, for politicians also see taxes as a potential regulatory tool. As Avi-Yonah writes, this third goal of taxation is 'regulation of private sector activity by rewarding activities that are considered desirable (via deductions or credits) and deterring activities that are considered undesirable (via increased taxation).'[42]

In order to promote desirable behaviour to advance all kinds of economic, social, cultural and health policy goals, governments provide tax incentives, micromanaging the choices of taxpayer. Dutch tax law is notorious for its incentives (tax expenditures), mostly in the form of tax reductions, e.g. for commuting by bike, employee's training, day-care centres, production of Dutch movies, research and development, ecologically sound investments or the letting of rooms by private persons. These tax incentives are deliberately introduced to stimulate taxpayers to act in a way that actually means paying less (or not more) tax. Tax increases and special levies provide disincentives to discourage taxpayers from engaging in practices deemed undesirable, such as smoking, alcohol consumption or environmentally polluting activities. Examples of disincentives employed include excises and environmental taxes.

Taxation is thus an overly cherished instrument in governments' regulatory tool kit. The regulatory function is too frequently favoured thereby shirking the responsibility for the distributive justice and fairness of the tax system. However, there are other consequences that should also be of serious concern.

41. A. Christians, 'Trust in the Tax System: The Problem of Lobbying', in Peeters, Gribnau & Badisco, above n. 5, at 152. To her mind governments should move towards achieving these aims by supporting and contributing to global, open-access data resources and independent tax policy research in the public interest.
42. R.S. Avi-Yonah, 'The Three Goals of Taxation', 60 *Tax Law Review* 1 (2006-2007), at 23. The regulatory function may of course impair the other functions.

4 Effects of Irresponsible Tax Legislative Behaviour

4.1 Erosion of Internal Morality

The upshot of the instrumentalist attitude of the tax legislature is that taxpayers, citizens and business alike, are incentivised to take a calculating attitude towards tax.[43] They are seduced to mitigate their tax by carefully attuning their behaviour to the financial impact of (encouraging or discouraging) tax provisions – and in doing so to the legislature's ends. Thus the legislature creates a good deal of tax planning. De Colle and Bennett aptly call this state-induced tax planning. 'Citizens, small entrepreneurs and MNEs can avail of these tax benefits in the knowledge that they are not only legal, but actually welcomed by tax authorities, as they are in fact introduced by a legislative body.'[44] The legislature wishes them to behave in a certain way and this behaviour is rewarded with a lower tax liability. Thus, businesses may have a low effective tax rate because they make use of tax incentives (e.g. for R&D). However, measures promoting research and development (and innovation) may imply a risk of profit shifting for intangibles are highly mobile and can be easily be transferred from one country to another.[45] Moreover, sometimes tax legislation incentivises the use of devices that are highly artificial – 'encouraging a culture of tax avoidance'.[46] Thus, legislatures fuel 'the growth of tax avoidance culture by relying on the taxation system to deliver a variety of tax unrelated subsidies and economic stimuli and (…) to drive social policy'.[47]

Businesses can also engage in aggressive tax planning by exploiting the letter of the law or loopholes in tax incentives. Thus they re-engineer tax incentives for tax avoidance. Of course, not only businesses but also wealthy taxpayers deploy sophisticated techniques to exploit never intended tax breaks, exemptions, etc.[48]

This state-induced tax planning may not live up to the legislature's intentions for taxpayers may overreact and

43. H. Gribnau, 'Corporate Social Responsibility and Tax Planning: Not by Rules Alone', 24 *Social & Legal Studies* 2 (2015a), at 230-31; <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2610090>.
44. S. de Colle and A.M. Bennett, 'State-induced, Strategic, or Toxic? An Ethical Analysis of Tax Avoidance Practices', *Business & Professional Ethics Journal* 33 (2014) 1, at 53-82 (§ 3.1).
45. E. Gil Garcia, 'The Effect of Anti-Avoidance Provisions Regarding the Promotion of Innovation: Considerations from a Tax Policy Perspective', *Bulletin for International Taxation* (October 2016), at 583. Bearing in mind that R&D (&I) schemes and intellectual property regimes may give rise to a risk of base erosion and profit shifting she explores the different possibilities that are used to counter tax avoidance and aggressive tax planning, and noting their effect on fiscal measures that are designed to encourage technological innovation.
46. Freedman (2006), above n. 20, at 371.
47. H. Ordower, 'The Culture of Tax Avoidance', *Saint Louis University School of Law Legal Studies Research Paper No. 2010-06*, at 6.
48. For schemes devised as 'a smoke screen for additional remuneration' for foreign football players in the UK, *see* Brooks, above n. 39. He concludes, that as a result of this level playing field 'British youngsters struggle to find places at the top level and the national team plumbs new depths of under-achievement' (at 154). He labels this as 'reverse protectionism' (at 162).

underreact to new tax incentives due to, e.g. tax complexity and cognitive ability.[49] Overreaction, for example, may have far too big an impact on the treasury. The legislature often underestimates this budgetary impact and therefore often reacts by changing the tax provisions containing the 'overused' incentive in order to diminish the budgetary impact. Thus the legislature is permanently looking for optimisation of the use of the tax instrument. Benefits and costs are calculated, and rules deliberately designed and redesigned to influence taxpayer's behaviour.

The widespread use of – often fiercely lobbied for – tax incentives is one of the major reasons for the ever-growing complexity of the tax system. Complexity goes at the expense of predictability. But also consistency in time is seriously lacking because of the all too frequent changes made by the legislature.[50] Thus legal certainty is seriously eroded, resulting in lower levels of compliance (sometimes uncertainty is even deliberately created to put off taxpayers).[51] Furthermore, important values such as consistency and transparency are treated in a stepmotherly way. Moreover, equality is at risk, for many taxpayers do not have the expertise to deal with tax complexity, which may negatively impact taxpayers' perception of the distributive justice and fairness of the existing tax system.

Thus, the result of this feverish and instrumentalist legislative activity is that tax legislation regularly violates important legal values and principles, such as legal certainty, equality, neutrality and consistency. To my mind, the tax legislature would do well to show more respect for legal principles, for they constitute the 'internal morality of law'.[52]

Legal principles are internal standards generated and developed by the legal system itself – although they are strongly influenced by (external) morality. They are thus intimately connected to society's moral values, and society's views on the integrity of the tax system.[53] Legislation that shows disdain for important legal and societal values does not command respect. Eroding the internal morality of the law may chip away at tax legislature's legitimacy, and may produce taxpayers' decreasing compliance.

4.2 Crowding Out Ethics

As argued earlier, fundamental legal-ethical principles may be crowded out in the taxpayers' decision-making process, such as the principle of equality and the ability-to-pay principle. These principles are enshrined in the law, both for the legislature and for the taxpayer. Many tax provisions, however, establish a rule-based context to encourage and even control the behaviour of the taxpayers and the taxpayers will play with the rules. The focus of both legislature and taxpayer is on rules, not on ethical behaviour.

As a result, a dominantly rule-bound regulatory and compliance focus is likely to undermine a more principle-based ethical thinking. This may cause both actors to (consciously) ignore tougher issues that a more ethics-focused approach might demand.[54] Moreover, not only actual ethical thinking is undermined, but even the intrinsic motivation to take into account ethical considerations to comply with the law.[55]

Taxpayers' tendency of viewing and using tax laws in a mechanistic, rule-based way is reinforced by the complexity and lack of transparency of the law. The resulting uncertainty about their legal rights and responsibilities incites taxpayers to carefully study the rules to improve certainty of their tax position and looking for opportunities to mitigate and even avoid paying their taxes.

In short, tax legislatures and taxpayers share a focus on rules. This mindset prevails in the interaction of these two fiscal actors. Tax statutes establish a rule-based context to control the behaviour of taxpayers and taxpayers will work around and play around with the existing rules.

5 International Tax Competition and Cooperation

5.1 Tax Competition: Narrow Self-interest vs. Responsibility

At an international level taxes are also used as policy instrument. Again, the state's hand is very effectively guided by intense corporate lobby activity with the aim of 'suspending competition between companies by inciting competition between locations competing for locations'.[56] Consequently, states use tax legislation to maintain and increase investment that companies make, which is expected to generate employment and tax revenues. In this way, states competing for investment take into account the interests of MNCs trying to meet their demand for favourable tax rules (in the lexicon, states and thus societies 'become indistinguishable from cor-

49. J. Abeler and S. Jäger, 'Complex Tax Incentives: An Experimental Investigation', *CESifo Working Paper No. 4231*, 2013.
50. S. Steinmo, 'The Evolution of Policy Ideas: Tax Policy in the 20th Century', 2 *British Journal of Politics and International Relations* (5 May 2003), at 218.
51. Empirical research has found that continuous changes and complexity in tax law have a negative effect on the level of compliance; E. Kirchler, *The Economic Psychology of Tax Behaviour*, Cambridge: Cambridge University Press (2007), at 39.
52. Fuller, above n. 6, at 200-24.
53. H. Gribnau, 'Not Argued From But Prayed To. Who's Afraid of Legal Principles?', 12 *eJournal of Tax Research* 1 (2014), at 203-6.
54. R.E. Berenbeim and J.M. Kaplan, *The Convergence of Principle- and Rule-Based Ethics Programs: An Emerging Trend*, The Conference Board, Executive Action Series (2007) 3.
55. B.S. Frey and R. Jegen, 'Motivation Crowding Theory', 15 *Journal of Economic Surveys* 5 (2002), at 594-5.
56. W. Streeck, *Buying Time: The Delayed Crisis of Democratic Capitalism*, (2nd edition), London: Verso (2017), at xvi.

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porations'[57]). As a result 'the tax law market' organised by competition has increasingly affected the state and the choice of its tax policy. Such choices might regard the effective tax rates, the statutory tax rates or the tax structure as a whole.[58] This specific kind of regulatory competition capitalizes on and reinforces businesses' leaning towards tax planning. International tax competition is thus an important cause of the ever-growing complexity of tax rules, which leads to higher compliance costs for multinational corporations and the need for tax planning.

Corporations commonly do not object to this tax competition when it means low (effective) tax rates or other kinds of favourable treatment. Indeed, business lobbyists try to influence (domestic) tax regimes, and sometimes business leaders feel no qualms about point blank threatening (the leaders of) countries with 'adverse effect on foreign investment'.[59] This shows that the instrumental use of taxation has a hotly debated international component. As a result there is a fierce tax competition among states, a form of regulatory competition. The tax legislature seduces taxpayers to behave according to his ends and thus creates a good deal of tax planning. The tax legislature itself is strongly encouraged by business interests.

One of the hallmarks of globalisation is the increased mobility of undertakings and especially capital investments. Companies and entrepreneurs have to compete on a global scale and accordingly consider low tax costs an important factor in deciding where to set up undertakings and invest capital. States respond to this increased mobility. Many states try to compete with their tax system in order to attract economic activities from other states. States see corporation tax as an important instrument in this bid for economic activity; for example, lower corporate taxes might induce multinational corporations not to allocate their profits to other countries.[60]

This international tax competition forces national governments to search for an optimal mix of public goods and services on the one hand, and low tax costs on the other. Of course, such policy competition between national tax systems may lead to budgetary and tax efficiency, which in principle benefits everyone.[61] Nonetheless, tax competition may also be economically counterproductive. Tax incentives commonly used by states in order to attract investment and capital from abroad can often have harmful effects. Such special tax schemes as tax holidays, selective base or rate reductions, and tax breaks may be designed solely to undercut competition. Such harmful tax competition is a far cry from tax efficiency and healthy jurisdictional competition, and it leads to 'fiscal degradation' (excessive erosion of countries' taxable bases on such income),[62] unfair tax advantages for multinational corporations over smaller local enterprises, over-taxation of labour, and a radical reduction of public goods and services and negative consequences for distributive justice.[63]

5.2 OECD

Twenty years ago international organisations became acutely aware of the dangers of harmful tax competition. In May 1996, for example the Ministers of the Member countries of the Organisation for Economic Cooperation and Development (OECD) called upon the OECD to 'develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases, and report back in 1998'.[64] This request was subsequently endorsed by the G7 countries, who pointed to the fact that globalisation was creating new problems in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities, such as financial and other service 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'.[65]

In 1998, the OECD's Committee on Fiscal Affairs published a report on harmful tax competition. This report addressed tax havens and harmful preferential tax regimes, collectively referred to as harmful tax practices, in OECD Member countries and non-Member countries and their dependencies. The OECD report was intended to develop a better understanding of how these harmful tax practices 'affect the location of financial and other service activities, erode the tax bases of other countries, distort trade and investment patterns and undermine the fairness, neutrality and broad social

57. M. Dobbin, *The Myth of the Good Corporate Citizen: Democracy under the Rule of Business*, Toronto / New York (NY): Stoddart (1998), at 2. Cf. C. Derber, *Corporation Nation: How Corporations Are Taking Over Our Lives and What We Can Do About It*, New York (NY): St Martins Press (1998), at 45: 'Today, global companies pit entire nations against each other, putting overwhelming pressure on unions around the worlds to agree cuts in wages and benefits, and on governments to agree to cuts in corporate regulations and taxes.'
58. C. Peters, *On the Legitimacy of International Tax Law*, Amsterdam: IBFD (2014), at 55. International tax competition thus contributes to the transformation of the tax state to the debt state – that is, 'a state which covers a large, possibly rising part, of its expenditure through borrowing rather than taxation, thereby accumulating a debt mountain that is has to finance with an ever greater share of its revenue'; Streeck, above n. 56, at 72-3. He subsequently points at the impact of this transformation on distribution – favouring affluent citizens.
59. 'Apple tax ruling must be overturned, says US business group', *The Guardian*, 16 September 2016 <https://www.theguardian.com/business/2016/sep/16/apple-tax-ruling-must-be-overturned-says-us-business-group>. A true business leader might call this 'political crap.'
60. M. de Wilde, 'Tax Competition within the European Union – Is the CCCTB Directive a Solution?', *ELR* (May 2014) No. 1, at 25-8. For an in-depth study of the political dimension of corporation tax issues, *see* J. Snape, *The Political Economy of Corporation Tax: Theory, Values and Law Reform*, Oxford / Portland: Hart Publishing (2011).
61. Cf. F. Vanistendael, 'Fiscal Support Measures and Harmful Tax Competition', 9 *EC Tax Review* 3 (2000), at 152-61.
62. C. Pinto, *Tax Competition and EU Law*, The Hague / London / New York (NY): Kluwer Law International (2003), at 11.
63. Cf. A.J. Menéndez, 'The Purse of the Polity', in E.O. Eriksen (ed.), *Making the European Polity: Reflexive Integration in the EU*, London: Routledge (2005), at 208.
64. Committee on Fiscal Affairs OECD, *Harmful Tax Competition: A Global Issue*, Paris: OECD (1998), at 8.
65. Communiqué issued by the Heads of State at their 1996 Lyon Summit, quoted in OECD (1998), above n. 6V4, at 8.

acceptance of tax systems generally. Such harmful tax competition diminishes global welfare and undermines taxpayer confidence in the integrity of tax systems.'[66] International cooperation demands that governments establish a 'common framework within which countries could operate individually and collectively to limit the problems presented by countries and fiscally sovereign territories engaging in harmful tax practices'.[67]

Since then important steps have been taken to curb harmful tax competition – the BEPS-project being the most recent one. International cooperation to push back negative externalities is hampered by states' sovereignty though. Taxation is at the core of countries' sovereignty, but in my view sovereignty should not be exercised in an irresponsible way, for the interaction of domestic tax rules sometimes leads to gaps and frictions. 'When designing their domestic tax rules, sovereign states may not sufficiently take into account the effect of other countries' rules.'[68] Coordination thus requires not to exercise sovereignty in an irresponsible way.

5.3 EU

In the European Union, an intergovernmental organisation, harmful tax competition has also been a serious point of concern for quite a few years.[69] A major achievement was the adoption of a comprehensive package to tackle harmful tax competition by the ECOFIN Council on 1 December 1997.[70] This package was composed of three linked elements: the Code of Conduct for Business Taxation, measures to eliminate distortions in effective taxation of savings income, and measures to eliminate withholding taxes on cross-border payments of interest and royalties between associated enterprises.

There is no scientific consensus on the theoretical definition of harmful tax competition and even 'empirical evidence is somewhat disputed by both economists and political scientists'.[71] However, with regard to the European Union (formerly the European Community; EC) Terra and Wattel argue that tax competition is commonly labelled harmful when member states merely damage each other's budget, no creation of economic activity being at issue, but rather 'artificial cross-border shifts of activities (or at least profit-reporting for those activities), causing a tax loss for the EC as a whole'.[72]

In subsequent years, many steps have been taken to curb harmful tax competition. The EU Code of Conduct for Business Taxation was an early follow up.[73] More recently the European Commission resorted to the EU State aid provisions and proposed the Common Consolidated Corporate Tax Base (CCCTB) of which a relaunch is currently anticipated. In January 2016 the Commission published the Anti Tax Avoidance Package (ATAP).[74]

5.4 Responsibility: Self-Restraint and Cooperation

The foregoing shows that harmful tax competition is of serious concern to states. States thus shows awareness that their primary responsibility lies with improving the international tax system. Indeed, cooperation is needed to avoid suboptimal responses by individual states or even a race-to-the-bottom.[75] States will always be reluctant to act unilaterally for being a first mover may result in a competitive disadvantage. The European Commission, for example, recently pointed out that several 'features of the Netherlands' tax system can be used in structures for aggressive tax planning'.[76] Regulatory competition is a fact of life. Countries have the right to compete with each other to attract investments – which are expected to generate employment and tax revenues. However, they should exercise self-restraint by taking into account other countries' interests. Moreover, coordination is also in their own interest. Sovereign countries therefore betray their external and internal responsibility if they do not exercise self-constraint.

It is thus to be expected that the ensuing closer cooperation on the international and European level will result in more responsible law-making and better rules. OECD's BEPS project and the European Commission's ATAP initiative are creating a minimum standard that would make it possible to put a halt to excesses of tax planning. Thus states can be seen as collaboratively

66. OECD (1998), above n. 64, at 9.
67. OECD (1998), above n. 64, at 8. OECD, *Toward Global Tax Cooperation. Progress in Identifying and Eliminating Harmful Tax Practice*, Paris: OECD (2000) constitutes another fundamental step in OECD's fight against harmful tax competition. For recent developments, *see* M.F. Nouwen, 'The European Code of Conduct Group Becomes Increasingly Important in the Fight against Tax Avoidance: More Openness and Transparency is Necessary', 45 *Intertax* 2 (2017), at 138-49.
68. OECD, *BEPS Action Plan*, Paris: OECD (2013), at 9.
69. In a subsequent report, the Commission underlined the need for a group of high representatives of Member States which should achieve consensus on the tax measures to be considered harmful in the EU context and on the common criteria for the identification with an eye to the establishment of a 'code of good conduct.'
70. This package was based on a proposal put forward by the Commission: *see* Paper Towards Tax Co-ordination in the European Union – A Package to Tackle Harmful Tax Competition, COM(97) 495, 1 October 1997, and A Package to Tackle Harmful Tax Competition in the European Union, COM(97) 564 final, 5 November 1997. OJ No. C 2, 6 January 1998, at 1.
71. C.M. Radaelli, 'The Code of Conduct against Harmful Tax Competition: Open Method of Coordination in Disguise?', 81 *Public Administration* 3 (2003), at 522.
72. B.J.M. Terra and P. Wattel, *European Tax Law*, Deventer: Kluwer (2007), at 111.
73. *See* H. Gribnau, 'Soft Law and Taxation: EU and International Aspects', 2008 *Legisprudence* II/2, at 81-5. <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2445018>.
74. *See* Communication from the Commission to the European Parliament and the Council, *Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU*, 28 January 2016, COM(2016) 23 final; <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016DC0023&from=EN>.
75. Peters, above n. 58, at 58 points at the WTO provisions on subsidies as the legal framework that is in place to curb harmful tax competition.
76. European Commission, *Commission Staff Working Document Country Report The Netherlands 2016 Including An In Depth Review on the prevention and correction of macroeconomic imbalances*, Brussels, 26 February 2016 Swd(2016), at 44. 87 Final; <http://ec.europa.eu/europe2020/pdf/csr2016/cr2016_netherlands_en.pdf>. In a footnote, the EC refers to 'an overview of the most common structures for aggressive tax planning and the provisions (or lack thereof) necessary for these structures to work', viz. Ramboll Management Consulting and Corit Advisory (2016), 'Study on Structures of Aggressive Tax Planning and Indicators', *European Commission Taxation Paper No 61*.

engaging in legal engineering in the sense of creating and improving legal regimes or systems by taking away inconsistencies and loopholes – 'for the benefit of society as a whole'.[77] Consequently, the integrity of the international tax system will gradually improve. Nonetheless, we should not be over-optimistic. A perfect, seamless international tax system is a utopian dream. Further improvements are possible, but tax systems by definition will always be imperfect and incomplete.[78] Moreover, mismatches (disparities or legal gaps) between the tax systems of various states will probably always exist. And with regard to (tax) treaties, treaty shopping, taking advantage of treaty rules, is not easily to be ruled out. The same goes for making use of low-tax jurisdictions. Therefore, whatever tax rules are in place, (corporate) taxpayers will always have some choice with regard to the applicable tax rules and their interpretation. However, as stated earlier, freedom of choice entails (moral) responsibility. Using tax rules therefore is inevitably a matter of exercising responsibility.

6 (Ir)responsible Corporate Tax Planning

6.1 Tax Planning: Law and Morality

OECD's BEPS Project is about tax planning, aggressive tax planning.[79] But what exactly is the phenomenon called tax planning? Unfortunately, there is no universally accepted definition of tax planning, nor of aggressive tax planning.

Partly due to the excessive use of tax legislation as a regulatory instrument, taxation regards almost every aspect of human life. This may be labelled the 'fiscalization' of our existence. Taxpayers of course want to be in control of their financial affairs of which their (future) tax liability is an important part. Sound decision-making with regard to important life events, such as where to live and work, when to retire and where to carry on an enterprise, must take potential tax consequences into account. In one way or another, (corporate) taxpayers have to plan their tax affairs to plan their life or develop their business strategy. As shown earlier, tax planning is often deliberately encouraged by tax legislation, accounting for a dynamic and reciprocal relationship between tax planning and tax legislation. Of course, not all tax planning is incentivised this way.

So tax planning is to a certain extent necessary to stay in control of one's financial affairs because many (possible) actions have tax consequences – for example, taking into account the rules regarding the deductibility of mortgage interest when buying a house. In this sense 'tax planning' can be used as a morally neutral term, for tax planning is aimed at providing certainty with regard to an important part of our financial affairs. As stated earlier, corporate governance may require (corporate) tax planning in order to avoid double taxation in an international context.[80] Tax planning may even be aimed at compensating for unreasonable tax liabilities caused by arbitrary laws or (corrupt) tax officials – especially in developing countries.[81] Moreover, individuals and businesses share a tendency to use tax rules to lower their tax bill.

Hence, some tax planning is a common affair for taxpayers and calling for a nuanced approach. Nearly all taxpayers are to some extent tax planners, though the intensity, the aggressiveness of their tax savings activities, differs. Factors determining tax planning behaviour are, e.g. the attitude towards tax, opportunities to avoid, expertise and risk appetite.

Tax planning is thus a very broad term encompassing a continuum ranging from tax mitigation to aggressive tax planning (and may be even tax evasion). To conceptualise tax planning in this broad way is necessary because the conventional distinction made by lawyers between tax evasion and tax avoidance allows by definition for a legal rather than a moral evaluation of tax planning practices. Tax evasion is an illegal activity, involving intentional non-disclosure or concealment, be it fraudulent or not.[82] Taken in its widest sense, the concept of (legal) tax avoidance comprises 'all arrangements to reduce, eliminate or defer a tax liability'.[83] A moral evaluation of tax planning practices requires broadening the scope of the concept 'tax planning' beyond a purely legal perspective, for law as a system of codified ethics is part of the (wider) public morality.

6.2 Tax Planning by Degrees

From a moral perspective, it may be useful to add the concepts of 'tax mitigation' and 'aggressive tax planning' to the legal concepts of 'tax evasion' and 'tax avoidance'. Mitigation is aimed at lowering 'one's tax by adopting patterns of economic behaviour that are within the spirit of applicable tax legislation and that may even be

77. Cf. S. Douma, *Legal Research in International and EU Tax Law*, Deventer: Kluwer (2014), at 41. Cf. J. Smits, 'Legal Engineering in an Age of Globalisation: Is There a Future for Jurisdictional Competition?', in E. Ritaine-Cashin (ed.), *Legal Engineering and Comparative Law* tome 2, Genève: Schulthess (2009), 51-7, at 52. To Smits legal engineering as such can be seen 'as the creation of legal structures that fulfil particular functional and practical purposes … dealing with specific social problems by society as a whole'.
78. The international tax regime has become unfair for it is outdated, flawed, and arbitrary; M.F. de Wilde, '"Sharing the Pie" Taxing Multinationals in a Global Market' (PhD-thesis, Erasmus University Rotterdam 2015), at 15. He develops an alternative framework for taxing multinational business proceeds in a global market.
79. For a critical discussion, *see* J.M. Calderón Carrero and A. Quintas Seara, 'The Concept of "Aggressive Tax Planning" Launched by the OECD and the EU Commission in the BEPS Era: Redefining the Border between Legitimate and Illegitimate Tax Planning', 44 *Intertax* 3 (2016), at 208-226.
80. R. Russo and J. van Trigt, 'Corporate Governance and Taxes', in R. Russo (ed.), *Tax Assurance*, Deventer: Wolters Kluwer (2015), at 39.
81. VBDO, *Tax Transparency Benchmark 2015*, Utrecht: VBDO (2015), at 11; <www.vbdo.nl>.
82. J. Hasseldine and G. Morris, 'Corporate Social Responsibility and Tax Avoidance: A Comment and Reflection', 37 *Accounting Forum* (2013) 1-14, at 5.
83. J. Freedman, 'Defining Taxpayer Responsibility: In Support of a General Anti-Avoidance Principle', 4 *British Tax Review* (2004), at 335-6.

encouraged by government policy'.[84] It is not a term of art from a legal perspective, as Prebble and Prebble rightly state. It can be taken to mean 'reducing one's tax in ways that a governing statute clearly encourages or permits; for example, taking a deduction for a gift to charity'.[85]

Aggressive tax planning, on the other hand, is not a rather innocent affair. The European Commission defines aggressive tax planning as 'taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability'.[86] According to the OECD, aggressive tax planning involves 'a tax position that is tenable but has unintended and unexpected tax revenue consequences'. Thus, according to the OECD, 'tax legislation can be misused to achieve results which were not foreseen by the legislators'.[87] Such a position on tax is taken 'without openly disclosing that there is uncertainty whether significant matters in the tax return accord with the law'. It is added that 'sometimes, revenue bodies would not even agree that the law is in doubt'.[88] The adjective 'aggressive' reflects the 'acknowledgment that MNEs' tax avoidance strategies have become more and more sophisticated, pushing the boundaries of the legislation and exploiting any loopholes in tax laws'.[89] They thus engage in quite an extreme form of legal engineering (or 'creative lawyering'): 'the inconsistencies and loopholes of legal systems are exploited to provide perfectly legal benefits'.[90] The phenomenon of 'stateless income' is a well-known example of aggressive tax planning. Kleinbard describes it

> as income derived for tax purposes by a multinational group from business activities in a country other than the domicile of the group's ultimate parent company but which is subject to tax only in a jurisdiction that is neither the source of the factors of production through which the income was derived, nor the domicile of the group's parent company.[91]

Multinational corporations engaging in aggressive tax planning or on in tax sheltering typically see tax as a profit centre.[92] Thus, according to Kleinbard 'U.S.-domiciled multinational firms have become adroit at moving income that as an economic matter is earned in high-tax foreign countries to very low-taxed ones.'[93] The large investments of these multinationals in aggressive tax planning technologies are very cost effective because, as Kleinbard points out, 'they are unencumbered by any of the antiabuse rules to which non-U.S. multinationals domiciled in jurisdictions with better designed territorial systems might be subject'. In short, aggressive tax planning while remaining within the letter of the law boils down to gaming the international system of rules as much as possible in order to maximise tax benefits.

Thus, tax planning comes in different degrees. It may be very aggressive (or even fraudulent, though the term 'tax planning' is probably better applied to lawful behaviour only) but that need not be the case. Tax planning may entail tax avoidance when taxpayers are arranging their affairs in order to pay less than their due without for example avoiding double taxation. However, one has the right to structure one's tax affairs in a tax-efficient way. Therefore, one cannot dismiss every engagement in tax planning or tax avoidance as unethical out of hand. Consequently, the ethical assessment of tax planning needs careful evaluation, being a matter of degree. It is also a matter of responsibility. One should not exercise a right in an irresponsible way. The same goes for the right to structure one's tax affairs to mitigate the amount of tax to be paid. However, there comes a point where tax planning becomes irresponsible.

As long as mitigation or avoidance regards a relatively small amount of tax, there seems not that much reason to bother from an ethical perspective but when actions become legally contrived, a turning point is reached. As for example Judith Freedman argues, tax avoidance becomes 'reprehensible where the legal analysis deviates from the economic substance and this is the case regard-

84. Z.M. Prebble and J. Prebble, 'The Morality of Tax Avoidance', 43 *Creighton Law Review* 3 (2010), at 707.
85. R. Prebble and J. Prebble, 'Does the Use of General Anti-Avoidance Rules to Combat Tax Avoidance Breach Principles of the Rule of Law? A Comparative Study', 55 *Saint Louis University Law Journal* (2010), 21, at 22; <www.slu.edu/Documents/law/Law%20Journal/Archives/Prebble_and_Prebble_Article.pdf>.
86. European Commission, *Recommendation on Aggressive Tax Planning*, C(2012) 8806 final, 6 December 2012, at 2. This recommendation addresses aggressive tax planning in the area of direct taxation.
87. OECD (2008), above n. 18, at 87. At 10 this study states that the term aggressive tax planning evolved from the term 'unacceptable tax minimization arrangements' which lacked a clear definition.
88. OECD (2008), above n. 18, at 87.
89. de Colle and Bennett, above n. 44 (§ 1.3). They are actually referring to 'aggressive tax avoidance'.
90. Smits, above n. 77, at 52 referring to Jeanneret-Druckman. To Smits legal engineering as such can be seen 'as the creation of legal structures that fulfil particular functional and practical purposes.' The activity of lawyers, accountants and other tax professionals to find the best legal solution to a particular problem can however become extremely and, indeed, aggressively focused on providing tax benefits. Cf. Douma, above n. 77, at 27-8 and 41.
91. E.D. Kleinbard, 'Through a Latte Darkly: Starbucks' Stateless Income Planning', *Tax Notes* (24 June 2013), at 1517-1518.
92. Making use of tax shelters – again a term with no universally accepted definition – can be classified as aggressive tax planning. Here, we see a difference in terminology; J. Braithwaite, *Markets in Vice, Markets in Virtue*, Oxford: Oxford University Press (2005), at 16: 'What Australians refer to as the market for aggressive tax planning, Americans refer to as the market for tax shelters.' Cf. M. Hanlon and J. Slemrod, 'What Does Tax Aggressiveness Signal? Evidence from Stock Price Reactions to News About Tax Shelter Involvement', 93 *Journal of Public Economics* 1-2 (2009), at 127, fn 4: 'Our use of the term refers to complex transactions used by corporations to obtain significant tax benefits probably never intended by the tax code; these transactions may not be illegal per se and their use, if detected, may trigger lengthy processes of IRS assessment and judicial appeal.' Cf. Calderón Carrero and Quintas Seara, above n. 79, at 209-10.
93. E.D. Kleinbard, '"Competitiveness"' Has Nothing to Do With It', *Tax Notes* (1 September 2014), at 1055.

less of the wording of the legislation in question'.[94] In short, tax planning aiming at the minimalising or even eliminating their tax liability becomes morally irresponsible.

6.3 Aggressive Corporate Tax Planning

The system of public goods and services paid for by taxes contributes to the success of businesses. In order to be competitive and profitable, companies rely on government to educate young people who may become valuable employees, to provide for infrastructure enabling workers to commute and efficient transport of goods, to spark innovation, encourage investment, enhance worker productivity, raise production standards, and foster the efficient use of scarce resources. Nonetheless, taxation is part of businesses' cost-calculation, tax planning being a means of saving in expenses. Corporations deftly play with the rules thereby sharing a rule-focus with the legislature. Complex and unclear rules are carefully studied to be gamed with by businesses, and in turn the legislature supplements the existing body of rules with even more rules to curb this gaming. Thus, international companies seek to eliminate or reduce their tax liabilities. In an international context multinational companies nowadays exploit 'areas where several tax systems must interact and the scope for tax arbitrage, playing the rules of one system off against another, is considerable'.[95] Tax authorities often respond by establishing detailed rules, targeting relatively specific acts. However, taxpayers may react by using the loopholes inevitably present in very specific tax laws. Globalising corporations put complex business structures in place, which are extremely difficult for tax administrations to monitor and control. The result is a downward spiral: 'A smorgasbord of rules engenders a cat-and-mouse legal drafting culture – of loophole closing and reopening by creative compliance,' according to Braithwaite.[96] Unfortunately, the legislature cannot keep abreast of the tax avoidance industry.[97] Moreover, it takes time to appreciate and respond to new tax avoiding structures; the resulting time-lag between detecting and legislating gives the aggressive tax planner a temporal advantage.

Businesses may maintain that bending the rules may qualify as compliance, be it creative compliance with the letter of the law. Nevertheless, taxpayers may comply with (the letter of) the law, and still pay no tax at all. In this way, they totally undermine the rationale behind the words.[98] The essence of creative compliance is that it escapes the intended impact of the substantive law. Hence, these taxpayers evidently do not pay any fair share of taxes at all. The right to structure one's affairs in a tax-efficient way is pulled across its moral boundaries; this clearly does not show any sense of responsibility vis-à-vis society for the obligation to contribute financially to society is ducked.

Very expert corporate taxpayers are apparently able to determine the amount of tax they are willing to pay. They are largely free to choose whether and how much tax they want to pay. This violates the ideal of democracy. As shown earlier, corporate lobbying accounts for tax legislation, which is laws inevitably framed to meet corporate demand. Moreover, many expert multinational corporations also work around and play around with the existing tax rules. The latter goes at the expense of public revenue in times of austerity and amounts to a shift of the tax burden to less expert taxpayers, companies and citizens alike (level playing field). Maybe these multinationals do not have the formal right to set their own tax rates, but this is actually what often happens in practice. Some taxpayers are apparently more equal than others. This is a clear violation of one of democracy's basic tenets.

6.4 Undermining the Rule of Law

Aggressive tax planning implies dealing with the very basic values of a legal system in an irresponsible way. According to the German legal philosopher Gustav Radbruch, the legal system is aimed at justice with (formal) equality, legal certainty and purposiveness as its core values.[99] The purpose of tax law can be seen as contributing to the maintenance of society consonant with the requirement of distributive justice. Tax legislation serves (formal) legal equality and legal certainty, for the legislature determines the amount of tax to be paid and lays this down in tax laws with the purpose to instantiate the ideal of distributive justice.

The rule of law requires government to function through laws, i.e. general and abstract norms rather than specific and concrete decrees, which would amount to the rule of men. This requirement of general legislation serves as an important protection against arbitrary interferences with individual rights and liberties by the public authorities. This general law is opposed to any kind of individual command. It is an abstract rule that does not mention particular cases or individually nominated persons, but is issued to apply to all cases and persons in the abstract.[100] The capacity of law to provide security depends on a purely formal characteristic of law, namely its abstractness. By contrast, the capacity of law to promote equality stems from another formal characteristic of law, viz. the nature of the general norm as one which applies not just to an individual but to a class of individ-

94. Freedman (2006), above n. 20, at 362.
95. J. Shaw, J. Slemrod & J. Whiting, 'Administration and Compliance', in Institute for Fiscal Studies (IFS) (ed.), *Dimensions of Tax Design: The Mirrlees Review*, Oxford: Oxford University Press (2010), at 1151.
96. Braithwaite, above n. 92, at 147.
97. Cf. C.D. Stone, 'Why the Law Can't Do It', in T.L. Beauchamp and N.E. Bowie (eds.), *Ethical Theory and Business*, Englewood Cliffs (NJ): Prentice Hall (1993), at 163.
98. D. McBarnet, 'When Compliance is not the Solution but the Problem: From Changes in Law to Changes in Attitude', in V. Braithwaite (ed.), *Taxing Democracy: Understanding Tax Avoidance and Evasion*, Aldershot: Ashgate Publishing (2003), at 229-30.
99. G. Radbruch, *Legal Philosophy* (trans. K. Wilk), in *The Legal Philosophies of Lask, Radbruch, and Dabin*, Cambridge (MA): Harvard University Press (1950), at 99 ff. *See* Gribnau (2014), above n. 53, at 185-217; <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2461247>.
100. F.L. Neumann, *The Rule of Law. Political Theory and the Legal System in Modern Society*, Leamington Spa: Berg Publishers (1986), at 212-13.

uals and which can even be formed by all the members of a social group or society.[101]

Taxpayers deliberately structuring their affairs with an exclusive focus on the letter of the law exploit these two important formal characteristics of legislation. They appeal to the values of legal certainty and equality derived from the letter of the law, which is not consonant with distributive justice, which the legislature had in mind. They plan towards the inevitable imperfections of a system of tax rules. The legal qualification of their behaviour deviates from the economic substance, which is thus not taxed as it should be. Thus legal certainty and equality, important legal values meant to protect taxpayers against abuse of power of government and other citizens, are used to frustrate distributive justice.

The underlying attitude towards tax law reflects a strict formalistic view on the rule of law, entailing an ethical position based on a strict separation of law and morals.[102] Take for example the legal positivist Raz, who compares law to a knife. 'A good knife is, among other things, a sharp knife. Similarly, conformity to the rule of law is an inherent value of law, indeed it is their most important inherent value.'[103] Like other instruments, 'the law has a specific virtue which is morally neutral in being neutral as to the end to which it the instrument is put.' Aggressive tax planning takes advantage of law's adherence to formality at the expense of the substantive value of distributive justice. The formality of tax law, as Prebble and Prebble argue, 'is an essential prerequisite for contriving artificial transactions that enable the creators of the transactions or their clients to avoid tax'. To their minds, the benefits to society of legal certainty are thus outweighed by its detriments. I fully agree that this irresponsible behaviour 'exploits the formality of the law and, in doing so, exploits the values of the rule of law itself'.[104]

6.5 Tax Professionals

If law is seen as a knife, it is open to different uses. Tax law has become a very complex system of rules and principles, studied and applied by highly specialised professionals. Different types of professionals may provide tax advice, e.g. exclusive tax advisers, lawyers, accountants and others – in some jurisdictions the regulatory framework reserves tax advice exclusively to the tax advisory profession.[105] These professionals fulfil an important function, for many people are not able to meet their tax obligations without professional assistance. However, very expert tax advisers also use the legal knife to minimise the amount of tax paid by their client or employer. Tax professionals are thus involved in aggressive tax planning practices – doing their job in accounting firms, law firms or other tax advisory firms, in financial institutions or in large corporate taxpayers' (internal) tax departments.[106] They set up often very complicated structures – which may have some aesthetic attraction.[107] According to the UK Public Accounts Committee, the four large accounting firms Deloitte, Ernst and Young, KPMG, and PwC have guidelines 'to govern their tax advice, but they are still devising complex schemes that look artificial and their appetite for risk appears high – selling schemes that they consider only have a 50% chance of being upheld in court.'[108] Tax professionals exploit legal indeterminacy 'which is due to the disjuncture between legal form and economic purpose since different legal forms can be devised to achieve the same or a similar economic purpose'.[109] Thus the legislature has regulated certain behaviour based on a set of facts, and the tax professional devises a scheme with a different legal form for about the same economic substance. As Bogenschneider observes, corporate aggressive tax planning typically involves the 'manufacture' of a factually indeterminate transaction based on a purely formalistic understanding of tax laws.[110] In addition, the 'audit lottery' is often played: a favourable position – that the tax administration would likely challenge – is taken in the tax return without disclosure (for it is known that the risk of detection is minimal).[111] In this way, tax law is used as a tool to deconstruct and demolish the system, which distributes the

101. N. Bobbio, 'The Rule of Men or the Rule of Law', in N. Bobbio (ed.), *The Future of Democracy*, Minneapolis (MN): University of Minnesota Press (1987), at 143-4.
102. Gribnau (2015a), above n. 43, at 234-6.
103. J. Raz, 'The Rule of Law and its Virtue' [1977], in J. Raz (ed.), *The Authority of Law*, Oxford: Oxford University Press (2009), at 214. *See* for a discussion of Raz's position and a comparison with Hayek's and Fuller's position: H. Gribnau, 'Legal Certainty: A Matter of Principle', in H. Gribnau and M. Pauwels (eds.), *Retroactivity of Tax Legislation*, Amsterdam: EATLP (2013); <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2447386>.
104. Prebble and Prebble, above n. 85, at 45.
105. *See* D. De Widt, E. Mulligan & L. Oats, *Regulating Tax Advisers: A European Comparison of Recent Developments and Future Trends*, FairTax: Working Paper Series nr. 6, 2016; <http://umu.diva-portal.org/smash/record.jsf?pid=diva2%3A1055242&dswid=-4894>.
106. Cf. OECD (2008), above n. 17, at 5. Often tax schemes are not developed in response to any request from a company, *see* P. Sikka and H. Wilmott, 'The Tax Avoidance Industry: Accountancy Firms on the Make', *Working Paper, EBS Working Papers, Colchester* 2013:6 who quote a former Commissioner of the US Internal Revenue Service referring to a senior tax partner instructing 'to ignore a particular set of IRS disclosure rules. The reasoning was that the IRS 'was unlikely to discover the underlying transactions and that even if it did, any penalties assessed would be absorbed as a cost of doing business.
107. This is very well captured by A. Campbell, *On the Floor*, London: Serpent's Tail (2012), at 35: 'He creates complex financial structures like a child dresses a doll in different outfits.'
108. Public Accounts Committee (House of Commons), above n. 22, at 5. Cf. S.T. McGuire, T.C. Omer & D. Wang, 'Tax Avoidance: Does Tax-Specific Industry Expertise Make a Difference?', 87 *The Accounting Review* 3 (2012), at 975-1003 who argue that clients purchasing tax services from their external audit firm engage in greater tax avoidance when their external audit firm is a tax expert. Moreover, the tax-specific industry expertise of external audit firms appears to play a significant role in its clients' tax avoidance.
109. S. Picciotto, 'Indeterminacy, Complexity, Technocracy and the Reform of International Corporate Taxation', 24 *Social and Legal Studies* 2 (2015), at 170.
110. B. Bogenschneider, 'Professional Ethics for the Tax lawyer to the Holmesian "Bad Man"', 49 *Creighton Law Review* (2016) at 779: He explains: 'the corporate tax "planner" takes one set of given facts, where the application of tax law appears to determinatively result in the payment of tax under the law, and prospectively changes these facts to a second set of facts, where the application of the tax law is indeterminate.'
111. Braithwaite, above n. 92, at 114; Sikka and Wilmott, above n. 106.

tax burden over society and reduce it to its technicalities – thus separating its formal legal aspects from the instantiation of distributive justice it embodies. Tax law is disembodied from one of its intrinsic values. The letter of the law is hypostasised. However, the legality of a transaction or structure is not by definition sufficient to label it as morally acceptable. These professionals therefore do not take their responsibility for the integrity of the tax system very seriously. They act just like hired guns neglecting their public responsibility, for like all citizens they have a responsibility not to undermine 'the public frameworks that sustain our common existence'.[112]

These professionals adhere to and exploit formal characteristics of law. Formal conceptions of (the rule of) law are mistaken in making legal values absolute. However, as Radbruch rightly argues, 'non-conclusiveness' is a crucial feature of (legal) values. In practice, these components of justice must be constantly weighed and balanced, for there is no hierarchy between these fundamental legal values. This accounts for their non-conclusiveness (which they have in common with principles).[113] Therefore, invoking values such as legal certainty implies taking other values into account and perform a balancing act. A value disproportionally negatively impacted may be a sound reason to not let it prevail over another value.

To my mind, therefore, morally acceptable tax planning cannot be reduced to a formalistic compliance with tax rules. The ethical stance involved in the interpretation and use of legal rules should be less formalistic. Ethical behaviour cannot be reduced to strict rule-following – deliberately disregarding the underlying values and principles of the tax system.[114] Rules demand interpretation, which in turn should be guided by some ethical view. But even if clear-cut rules are available, formalistic compliance with the rules of two or more different tax jurisdictions may result in the payment of nil corporate tax in each of these countries. Perfectly legal and compliant behaviour, therefore, may lead to a result that might be deemed illegitimate and unethical.[115] Thus, irresponsibility is disguised in the cloak of legality.

7 Tax Corporate Irresponsibility

7.1 Corporate Moral Agency

As shown earlier, very expert corporate taxpayers are apparently able to determine their tax liability. They are largely free to choose whether and how much tax they will pay. However, responsibility comes with freedom. Corporations are therefore required act, for example in regard to their tax planning, responsibly by confining their pursuit of self-interest. This begs the question: can a corporation act responsibly? Does a corporation have the freedom to act and bear responsibility for its actions like a natural person has freedom and responsibility? It is clear that a corporation has freedom to choose among different options within the boundaries of the law. But how about corporate responsibility?

There is no denying that a corporation differs from a natural person. Individuals are raised in a community. They are made to behave responsibly, i.e. to take into account the interests of others to some extent, e.g. by identification with others brought about by socialisation and external sanctions.[116] Coleman argues that the large modern corporation 'has none of the encumbrances, responsibilities, and informal community obligations that arose through the personal and family connections of the owner of the old, family-based corporation'.[117] His point is that the modern multinational corporation is not embedded in a community to which it is tied by (informal) obligations. Hence, socialisation and norms applied to natural persons no longer constitute effective means for ensuring responsible corporate action, for corporations are constructed 'around the positions of which natural persons are merely temporary occupants'.[118]

Nonetheless, in their communication multinationals like Nike convey the image of an 'actual' personality rather than just a concrete corporate person. Thus Nike aspires to be one of the few global leaders with an actual personality in which customers believe instead of just buying its goods.[119] This self-image of an 'actual' personality reinforces the conviction that morality does not regard only individuals. Corporations qualify as moral agents as well, because they 'have their own decision-making structures, have choices, and justify them with corporate reasons'.[120] Corporations are legal entities, i.e. artificial persons in law, but also moral entities, i.e. they have agency independent of their members. Companies can refrain from harming others. Moreover, they can account for their behaviour by giving moral reasons and

112. R.W. Gordon, 'Why Lawyers Can't Just be Hired Guns', in D.L. Rhode (ed.), *Ethics in Practice: Lawyers' Roles, Responsibilities, and Regulation*, New York / Oxford: Oxford University Press (2003), at 47.
113. Gribnau (2014), above n. 53, at 185-217; <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2461247>.
114. Dworkin, above n. 2, at 300-1. Cf. Gribnau (2015a), above n. 42, at 241-5.
115. Cf. R.F. van Brederode, 'A Normative Evaluation of Tax Law Enforcement: Legislative and Political Responses to Tax Avoidance and Evasion', 42 *Intertax* 12 (2014), at 768 on the doctrine that recognises 'the right of an individual to structure his affairs as he sees fit and to lower his taxes as long as this does not violate the spirit of the law.'
116. J. Coleman, *Foundations of Social Theory*, Cambridge (MA) / London: The Belknap Press of Harvard University Press (1990), at 556.
117. Coleman, above n. 116, at 559.
118. Coleman, above n. 116, at 576.
119. Barber, above n. 34, at 67. He makes reference to Nike's 1992 Annual Report.
120. M.T. Brown, *Corporate Integrity: Rethinking Organizational Ethics and Leadership*, Cambridge: Cambridge University Press (2005), at 123. *See* Gribnau and Jallai, above n. 10, at 4-5.

assume moral responsibility for their actions affecting others. Thus, corporations have a kind of moral responsibility that differs from the responsibility of the individuals constituting the corporation. Companies engaging in corporate social responsibility (CSR) are an example of moral agency. They are part of society, which entails obligations towards society. It may be more difficult for a multinational corporation to take the morally correct action because operating in many countries affects usually many more stakeholders than a national firm. Nonetheless, the increased difficulty does not change the nature of the moral obligation: 'multinationals, like nationals, are required to consider the interests of all corporate stakeholders'.[121]

7.2 MNCs Engaging in CSR

Multinationals often have a huge impact on society and communities.[122] Many multinational corporations nowadays emphasise their connections with communities. Take for example Starbucks: they believe that they should have 'a positive impact on the communities we serve'.[123] In the same vein, Kris Engskov, managing director, Starbucks Coffee Company, UK, states: 'the most important asset we have built is trust. Trust with our partners (employees), our customers and the wider society in which we operate'.[124] So apparently a multinational like Starbucks feels embedded in society and therefore attaches great interest to good relations with stakeholders – implying trust and confidence. It shows concern for society and it claims to have internalised external interests, viz. the interests of society at large. Thus, the OECD pointing at 'the mutual dependence of business and society' seemingly perfectly captures Starbucks' ideas. Actually, Starbucks cannot but endorse the OECD's point of view that it is all about corporate responsibility, where CSR refers to 'the actions taken by businesses to nurture and enhance this symbiotic relationship'.[125] The OECD correctly states that this symbiotic relationship is not a given but involves a search for an effective 'fit' between businesses and the societies in which they operate. CSR should include tax, for corporate responsibility should cover all corporate behaviour. Selective shopping is out of the question, for it would imply the company lacking integrity. Starbucks, therefore, should make sure that it is not an example of corporations that talk 'about social responsibility, but indulge in tax avoidance and evasion'.[126]

MNCs' voluntary engagement in CSR is acceptance of ethical obligations beyond (strict) compliance with the law. The acceptance of legal obligations as well as duties that, though not required by law, 'underscore and reflect the nature of the company as an essentially social entity'.[127] Legal obligations, therefore, should not be narrowed down to the letter of the law nor should MNCs use and manipulate the tax rules without regard for the underlying principles in order to minimise their tax liability.

Companies should thus think in terms of good tax governance whereby tax is not seen as just a cost. Here, there is a role to play for – both in-house and external – tax advisers who have a relationship of trust with their clients, for example by making 'a clear commercial case for responsible behaviour based on evidence of a "business case" for CSR'.[128] Tax adviser Van Eijsden indeed provides a business case to include tax as a corporate responsibility issue.[129] It follows that tax advisers should make sure that the corporation's tax practice is aligned with its CSR strategy. The same goes for external tax advisers on whom a company relies, they have to assume responsibility and take care to connect their recommended tax planning structures with the company's CSR strategy.[130] Very expert tax professionals also have the capacity 'to play a constructive role in the development of better tax legislation'.[131] They should therefore participate in policy discussions and committees in order to enhance the integrity of the tax system.

Still, the question is what is corporate responsibility with regard to tax? What kind of responsibility has a company in relation to tax? There is no consensus on principles of tax fairness yet, which flesh out the ideal of a fair share in international taxation and offer multinational companies guidance. The ideal of a fair share is therefore too vague, ambiguous and abstract to give clear guidance on the amount of (corporate) tax to be paid by multinational corporations. Moreover, the specific economic nature of the (legal) obligation to pay tax has to be taken into account: everyone has the right to structure one's tax affairs in a tax-efficient way. This goes for enterprises and citizens alike. Thus self-interested behaviour collides with the interest of society, the

121. N. Bowie, 'The Moral Obligations of Multinational Corporations', in Beauchamp and Bowie 1993, at 520.
122. Cf. Tapscott and Ticoll, above n. 33, at 183: 'When Starbucks opens a store, it may change the character of a neighborhood. When it buys more Fair Trade coffee, it may change the social, political, economic and environmental dynamics of a town in El Salvador. When it puts Wi-Fi into a café, it may become a hub for a local business community – or a peace demonstration.'
123. John Kelly, senior vice president, Global Responsibility and Public Policy at <www.starbucks.co.uk/our-commitment>. He tells us that in '2008 we set a series of ambitious goals where we felt we could use our scale for the greatest good in the areas of ethical sourcing, environmental impact and community improvement.
124. *An Open Letter from Kris Engskov*, 06 December 2012; <www.starbucks.co.uk/blog/an-open-letter-from-kris-engskov/1249>.
125. OECD, *Corporate Social Responsibility: Frequently Asked Questions*, <www.oecd.org/corporate/mne/corporateresponsibilityfrequentlyaskedquestions.htm>, accessed 4 October 2016.
126. P. Sikka, 'Smoke and Mirrors: Corporate Social Responsibility and Tax Avoidance', 34 *Accounting Forum* (2010), at 153-68.
127. J. Canals, *Building Respected Companies: Rethinking Business Leadership and the Purpose of the Firm*, Cambridge: Cambridge University Press (2010), at 147.
128. H. Ward, *Corporate Responsibility and the Business of Law*, London (2005), at 11; <http://pubs.iied.org/pdfs/G00195.pdf>.
129. A. van Eijsden, 'The Relationship between Corporate Responsibility and Tax: Unknown and Unloved,' *EC Tax Review* 1 (2013), at 56-61. Cf. Williams, above n. 17.
130. Cf. M.D. Bayles, 'The Professional-Client Relationship', in C. Callahan (ed.), *Ethical Issues in Professional Life*, New York / Oxford: Oxford University Press (1988), at 119.
131. G. Brock and H. Russell, 'Abusive Tax Avoidance and Institutional Corruption: The Responsibilities of Tax Professionals', *Edmond J. Safra Research Lab Working Papers*, 2015 No. 56, 17 February, at 34.

results of self-interested actions negatively affect the well-being of other persons (taxpayers).

How should these diverging interests be balanced? As argued earlier, irresponsible behaviour is behaviour that does not sufficiently take into account the interests of others – bringing (disproportionate) harm to them (Section 2.2). To my mind, MNEs do well to avoid aiming to pay a minimalist amount of (corporate income) taxes – thus eroding the integrity of the (international) tax system. Their aim should be to avoid corporate tax irresponsibility: evidently not paying a fair share. In practice, it is far easier to agree on evident instances of injustice than on what counts as justice.[132] So given the right to structure one's affairs so as not to pay too much tax, the primary aim should be to avoid irresponsible and profoundly unfair tax planning rather than to strive for the vague ideal of paying a fair share.

8 Conclusion

The international tax system is the result of the interaction of different actors, such as legislatures, tax administrations, courts, taxpayers, tax advisers and international organisations, who share the responsibility for its integrity. This article mainly focused on states and multinational corporations (and their tax advisers). They both enjoy to a certain extent freedom of choice with regard to their tax behaviour – which entails moral responsibility. Making, interpreting and using tax rules therefore is inevitably a matter of exercising responsibility. Both should abstain from viewing tax laws as a bunch of technical rules to be used as a tool without any intrinsic moral or legal value. States bear primary responsibility for the integrity of the international tax system. They should become more reticent in their use of tax as regulatory instrument – competing with one another for multinationals' investment. States should act more responsibly by cooperating to make better rules to prevent aggressive tax planning, which entails a (disproportionate) shift in tax payments from very expert taxpayers to other taxpayers. Here, the distributive justice of the tax system and a level playing field should be guaranteed. Multinationals should abstain from putting pressure on states and lobbying for favourable tax rules, which disproportionally affect other taxpayers – SMEs and individual taxpayers alike. In the same vein, multinationals and their professional advisers should avoid irresponsible conduct by not aiming to pay a minimalist amount of (corporate income) taxes – merely staying within the boundaries of the letter of the law. Shared responsibility should be taken seriously by both states and multinational corporations; they should not pass the responsibility for the integrity of the tax system to the other party. This goes all the more for companies engaging in CSR. Future research could flesh out principles of good tax governance for both states and multinational corporations in order to enhance accountability and transparency and enable monitoring by stakeholders.

132. A.-G. Jallai and J.L.M. Gribnau, 'Free to Choose? Responsible Tax planning, Corporate Governance and Corporate Social Irresponsibility', *TLS Working Paper*, forthcoming.

Corporate Taxation and BEPS: A Fair Slice for Developing Countries?

Irene Burgers & Irma Mosquera*

Abstract

The aim of this article is to examine the differences in perception of 'fairness' between developing and developed countries, which influence developing countries' willingness to embrace the Base Erosion and Profit Shifting (BEPS) proposals and to recommend as to how to overcome these differences. The article provides an introduction to the background of the OECD's BEPS initiatives (Action Plan, Low Income Countries Report, Multilateral Framework, Inclusive Framework) and the concerns of developing countries about their ability to implement BEPS (Section 1); a non-exhaustive overview of the shortcomings of the BEPS Project and its Action Plan in respect of developing countries (Section 2); arguments on why developing countries might perceive fairness in relation to corporate income taxes differently from developed countries (Section 3); and recommendations for international organisations, governments and academic researchers on where fairness in respect of developing countries should be more properly addressed (Section 4).

Keywords: Fairness, international tax, legitimacy, BEPS, developing countries

1 Introduction

1.1 OECD's BEPS Action Plan, Low Income Country Report, Multilateral Instrument and Inclusive Framework

1.1.1 BEPS Action Plan

In 2013 the G20 meeting in St. Petersburg[1] endorsed the Base Erosion and Profit Shifting (BEPS) Action Plan. In its Action Plan, the OECD calls for 'fundamental changes to the current mechanisms and the adoption of new consensus-based approaches, including anti-abuse provisions, designed to prevent and counter base erosion and profit shifting'. According to the OECD, aggressive tax planning 'undermines the fairness and integrity of tax systems because businesses that operate across borders can use BEPS to gain a competitive advantage over enterprises that operate at a domestic level. Moreover, when taxpayers see multinational corporations legally avoiding income tax, it undermines voluntary compliance by all taxpayers.'[2] Aggressive tax planning has 'led to a tense situation in which citizens have become more sensitive to tax fairness issues'.[3]

The OECD does not provide for a definition of aggressive tax planning, but it does provide a definition of Base Erosion Profit Shifting: 'Base erosion and profit shifting (BEPS) refers to tax planning strategies that exploit gaps in the architecture of the international tax system to artificially shift profits to places where there is little or no economic activity or taxation.' This definition is more or less similar to what European Commission perceives as aggressive tax planning. According to the European Commission, aggressive tax planning 'exploits the differences in tax systems by taking advantage of the technicalities of a tax system or of mismatches between two or more tax systems for the purpose of reducing tax liability'.[4] Therefore, presumably the OECD refers to the type of tax planning that results in BEPS.

The OECD stated that all parties, governments and individual taxpayers are harmed including also business since 'fair competition is harmed by the distortions induced by BEPS'.[5] Therefore, the OECD developed fifteen Actions including among others, actions dealing with hybrid mismatches, limitation of interest deductions, actions recommending the introduction of CFC rules, rules to prevent the artificial avoidance of PE status, eliminating harmful tax regimes, dealing with tax treaty abuse and with transfer pricing, the disclosure of aggressive tax planning arrangements, and improvement

* Irene Burgers is Professor of International and European Tax Law, Faculty of Law, and Professor of Economics of Taxation, Faculty of Business and Economics, University of Groningen. Irma Mosquera, Ph.D. is Senior Research Associate at the International Bureau of Fiscal Documentation IBFD and Tax Adviser Hamelink & Van den Tooren.

1. G20 Leaders Declaration meeting in St. Petersburg including the Tax Annex to G20 leaders declaration; *see* <https://www.oecd.org/g20/summits/saint-petersburg/Tax-Annex-St-Petersburg-G20-Leaders-Declaration.pdf> (last visited 22 March 2017).
2. *See* 'About BEPS and the inclusive framework', <www.oecd.org/tax/beps-about.htm> (last visited 22 March 2017). Fairness is one of the tax principles the OECD formulated in its Ottawa Tax Framework, as revised in 2005 by the OECD Technical Advisory Committee (TAC). As to the OECD, 'this principle implies that the potential for tax evasion and avoidance should be minimised while keeping counteracting measures proportionate to the risks involved'. OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (2015), at 17; *see* <http://dx.doi.org/10.1787/9789264241046-en> (last visited 22 March 2017).
3. OECD, *Action Plan on Base Erosion and Profit Shifting* (2013), at 8; *see*<http://dx.doi.org/10.1787/9789264202719-en> (last visited 22 March 2017).
4. The European Commission Recommendation of 6 December 2012 on Aggressive Tax Planning C (2012)8806 Final, at 2.
5. OECD, above n. 3, at 8.

of the mutual agreement procedure. The content of the BEPS Actions was decided and approved by the BEPS 44 group, which includes OECD, OECD accession countries and G20 countries.[6] This article focuses on the developing countries that are for the purpose of this article defined as non-OECD, non-G20 countries and are therefore not represented in the BEPS 44 group.[7]

1.1.2 Will BEPS Reduce Aggressive Tax Planning?

A question that, to our best knowledge, neither the OECD nor IMF, UN or World Bank addressed, but has been addressed in academic literature, is whether BEPS will contribute to more economic fairness by reducing the incentive of multinationals to use aggressive tax planning. Martin Thomsen and Christoph Watrin found no evidence that multinationals are more tax aggressive than domestic firms. Their findings do not support the need for a coordinated international tax policy to prevent base erosion nor suggest that multinational companies should be blamed. Thomsen and Watrin call for governments to carefully consider the steps they take to address the OECD's BEPS project as well as for future research clarifying the concept of tax avoidance for international tax policy debates.[8]

1.1.3 Low Income Countries Report Part 1 and 2

In its 2014 Report to G20 Development Working Group on the impact of BEPS in Low Income Countries ('2014 Report') Part 1 and Part 2,[9] the OECD identified the following differences on the basis of a questionnaire sent to developing countries, direct consultations with developing countries and the experiences of four international organisations (IOs):

a. The nature of cross-border tax planning may differ between developing and developed countries;
b. Developing countries may lack the necessary legislative measures needed to address BEPS;
c. Accessing relevant information is often difficult;
d. Building and maintaining capacity to implement highly complex international rules leave room for discretion in their application;
e. Need for political impetus and support for effective measures to counter BEPS highlighted in regional consultations;
f. The acute pressures on developing countries to attract investment can trigger a competitive 'race to the bottom'.

OECD has also mapped the following Actions that developing countries consider as the most important for developing countries:[10]

- Action 4 – Limit base erosion via interest deductions and other financial payments;
- Action 6 – Prevent treaty abuse;
- Action 7 – Prevent the artificial avoidance of PE status;
- Action 10 – Assure that transfer pricing outcomes are in line with value creation – other high-risk transactions;

6. The BRICS countries are regarded as emerging economies and even though these countries are non-OECD countries, they have a role in decision making by being members of the G20 and by participating on equal footing in the BEPS 44 group. BRICS stands for Brazil, Russia, India, China and South Africa.
7. This article uses the distinction between developed and developing countries to distinguish between countries members of the OECD or G20 (developed countries) and other countries (developing countries). This classification is useful for the purposes of this article, which is to differentiate between OECD and G20 vs. non-OECD, non-G20 countries. This has also been the approach of the OECD when addressing Low Income Countries in its 2014 report. However, other classifications of countries may exist in scholarship taking into account the economic GDP (*e.g.* emerging economies), the dependence on aid, and the lack of a modernised tax administration, among others. *See*, for an economic approach between developed and emerging economies, the Emerging and Growth Leading Emerging Economies EAGLEs 2014 Economic Outlook made by the BBVA (a bank) Research Unit; *see* <https://www.bbvaresearch.com/KETD/fbin/mult/2014_EAGLEs_Economic_Outllok-Annual_tcm348437158.pdf?ts=3132014> (last visited 22 March 2017). Taking a legal perspective, Mosquera, when analysing in a 2015 publication the aggressive tax planning in South America and Sub-Saharan Africa, has argued that no one size fits all. The author also argued that the economic development of the countries in South America and Sub-Saharan Africa is different among countries and among regions. In order to find these differences, Mosquera provided a comparative analysis of the rules to deal with aggressive tax planning in South America and Sub-Saharan African regions taking into account the country's economic development, tax administration capacity and resources, and the use (or not) of domestic laws and tax treaty rules to tackle aggressive tax planning. The author concluded that from these regions some countries may be sensitive to BEPS issues including aggressive tax planning while for other countries aggressive tax planning is not yet the main issue since these countries are at the early stages of developing their own tax systems. *See* I.J. Mosquera Valderrama, 'The BEPS Measures to Deal with Aggressive Tax Planning in South America and Sub-Saharan Africa: The Challenges Ahead', 43 *Intertax* 10, at 615-27 (2015).
8. M. Thomsen and C. Watrin, *Do We Really Need the BEPS Project?*; *see* <https://business.illinois.edu/accountancy/wp-content/uploads/sites/12/2015/09/Tax-2015-Thomsen-Watrin.pdf> (last visited 22 March 2017).
9. In the first part of the Report, the OECD evaluates the impact of the Action Plan in Low Income Countries and it adds other issues that should be considered for these countries that are not included in such action plan (*e.g.* use of tax incentives by developing countries). In the second part of the Report, the OECD presents the potential actions to assist developing countries to meet the challenges of the most relevant actions of BEPS. OECD, *Part 1 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries* (2014); *see* <https://www.oecd.org/g20/topics/taxation/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf> (last visited 22 March 2017). OECD, *Part 2 of a Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries* (2014); *see* <https://www.oecd.org/g20/topics/taxation/part-2-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf> (last visited 22 March 2017).
10. According to the reporters of medium importance are:
    - Action 1 – Address the tax challenges of the digital economy;
    - Action 5 – Counter harmful tax practices more effectively;
    - Action 8 – Assure that transfer pricing outcomes are in line with value creation – intangibles;
    - Action 9 – Assure that transfer pricing outcomes are in line with value creation – risks and capital;
    - Action 12 – require taxpayers to disclose their aggressive tax planning arrangements;
    - Action 14 – Make dispute resolution mechanisms more effective; and of low importance for developing countries are:
    - Action 2 – Neutralise the effects of hybrid mismatch arrangements;
    - Action 3 – Strengthen controlled foreign company rules;
    - Action 15 – Develop a multilateral instrument.

– Action 11 – Establish methodologies to collect and analyse data on BEPS and the actions to address it;
– Action 13 – Re-examine transfer pricing documentation.

The OECD recognises in this Report that developing countries have other needs than developed countries in respect of both tax design and tax administration, and that the BEPS issues may manifest differently for developing countries given the specialties of their legal and administrative governing framework. The OECD furthermore states that a further issue for 'developing countries, which was raised during the regional consultations, is the balance between source and residence taxation embodied in bilateral tax treaties modelled on the OECD and UN Model Tax Conventions. This is an issue of allocating taxing rights between two treaty partners. It is not a tax planning/avoidance issue and does not give rise to BEPS.'[11] Despite being outside the scope of BEPS, the OECD stated in the 2014 Report that 'this is an issue of significance for many developing countries, and that the OECD/G20 BEPS Project provides an opportunity to lay the ground for this legitimate debate'.[12] To the authors' knowledge, no further reference has been made to the fairness of the present allocation of taxing rights between treaty partners' allocation of taxing rights in the BEPS Actions nor in the discussion draft of the BEPS Multilateral Instrument.[13]

1.1.4 Multilateral Instrument

In October 2015, the OECD presented to the G20 Meeting of Finance Ministers in Lima (Peru), the final package of the fifteen Actions for a comprehensive, coherent and co-ordinated reform of the international tax rules. Among these Actions, Action 15 provides for a Multilateral Instrument.

In the discussion of this Multilateral Instrument not only countries of the BEPS 44 group are participating but developing countries are also participating. Developing countries have been invited to participate what the OECD refers to as 'on equal footing' in this discussion. The participation on equal footing by developing countries was introduced by the OECD to address the concerns of legitimacy and participation of developing countries that did not belong to the BEPS 44 group. For this purpose, the OECD set up an Ad Hoc Group to develop the BEPS Multilateral Instrument and to address mainly Actions 2, 6, 7 and 14.[14] This Ad Hoc Group includes more than hundred countries (OECD and G20 countries, developing countries), as well as a number of non-State jurisdictions and international organizations participating as Observers.[15] This Multilateral Instrument has been adopted in the meeting on 24-25 November 2016.[16]

1.1.5 Inclusive Framework

In the Meeting in Kyoto, Japan (29 June 2016-1 July 2016) the OECD presented an inclusive framework for the implementation of BEPS. This Inclusive Framework allows countries and jurisdictions outside the BEPS 44 group to participate as BEPS Associates on the implementation of BEPS. The BEPS Project and its Inclusive Framework contains four minimum standards Actions 5,[17] 6,[18] 13[19] and 14[20] that should be implemented into the tax system of the countries participating in this framework. The other Actions (1-4 and 7-12) comprise recommendations and best practices for countries to implement. At the time of writing this article, more than ninety countries are participating in the BEPS Inclusive Framework.[21]

1.1.6 Problems of Legitimacy

The current developments on the BEPS project show that not only the countries that are members of the BEPS 44 group, but also developing countries are participating in the discussion of the BEPS Multilateral Instrument and as BEPS Associates in the Inclusive Framework to implement BEPS Actions.

Against this background, the authors argue that the participation on equal footing of developing countries in the BEPS Multilateral Instrument and the Inclusive Framework are not sufficient to legitimise the role of the OECD and the BEPS 44 group in setting international tax standards for developing countries. The reason is that there has not been a true decision-making process

11. OECD (2014), above n. 9, at 9; *see* <https://www.oecd.org/g20/topics/taxation/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf> (last visited 22 March 2017).
12. *Ibid*.
13. Neither the report on Action 15 of the BEPS Action Plan nor the Public Discussion draft mention the allocation of taxing rights. *See* OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 – 2015 Final Report* (2015); *see* <http://dx.doi.org/10.1787/9789264241688-en> (last visited 22 March 2017) and OECD, *Public Discussion Draft BEPS Action 15: Development of a Multilateral Instrument to Implement the Tax Treaty Related BEPS Measures* (2016); *see* <www.oecd.org/tax/treaties/BEPS-Discussion-draft-Multilateral-Instrument.pdf> (last visited 22 March 2017).
14. These actions deal with hybrid mismatches, treaty abuse, permanent establishment and mutual agreement procedure. According to the OECD, the negotiation in the ad hoc Group was focused on how the Convention would need to modify the provisions of bilateral or regional tax agreements in order to implement those measures. *See* OECD, *A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS, Action 15 – 2015* (2015); *see* <www.oecd.org/ctp/beps-action-15-mandate-for-development-of-multilateral-instrument.pdf> (last visited 22 March 2017).
See explanatory statement to the multilateral instrument <https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf> (last visited 22 March 2017).
15. *See* <www.oecd.org/tax/treaties/multilateral-instrument-for-beps-tax-treaty-measures-the-ad-hoc-group.htm> (last visited 22 March 2017).
16. *See* <www.oecd.org/tax/countries-adopt-multilateral-convention-to-close-tax-treaty-loopholes-and-improve-functioning-of-international-tax-system.htm> (last visited 22 March 2017).
17. Countering Harmful Tax Practices more effectively, taking into account transparency and substance.
18. Preventing the granting of treaty benefits in inappropriate circumstances.
19. Transfer Pricing Documentation and Country by Country Reporting.
20. Making Dispute Resolutions more Effective.
21. *See* <www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf> (last visited 22 March 2017).

since the content of BEPS Actions has been decided by the BEPS 44 group with developing countries having only a consultative role. The analysis of legitimacy and participation of developing countries has been made by Mosquera elsewhere.[22]

1.1.7 Why Are Developing Countries Participating in the BEPS-Project?

Despite the problems of legitimacy and the different needs of developing countries, developing countries such as Nigeria, Burkina Faso, Senegal, Bangladesh, Eritrea, Sri Lanka and Pakistan amongst others are participating in the inclusive framework to implement BEPS.[23] It is not clear why these developing countries are participating in BEPS. To the authors' best knowledge, no research is available on this issue. Some indication of the reason that these countries are participating in BEPS could be found in their need to receive technical assistance and to gain more specialised knowledge on transfer pricing.[24] These have been some of the concerns addressed by developing countries in the questionnaire on BEPS issues developed by the UN Subcommittee on BEPS for developing countries. The response to this questionnaire was limited since only four developing countries replied (Tonga, Lesotho, Ghana and Zambia).[25] Surprisingly enough, these four countries are not participating in the inclusive framework for reasons that have not yet been investigated. Research on the reasons why countries have adopted BEPS is outside the scope of this article; this article focuses on the different perspective of fairness between developing and developed countries. Further research is recommended on the motivation of developing countries to participate in BEPS and the specific problems in the implementation of BEPS in developing countries.

1.1.8 Concerns of Developing Countries on Lack of Technical Resources

As mentioned in the OECD's Low Income Report, the lack of technical resources, personnel capacity, technical knowledge and economic means of developing countries constitutes a challenge for these countries to implement measures concerning international assistance. This most likely is also the case for the BEPS Multilateral Instrument and the BEPS four minimum standards and to achieve outcomes favourable to them.

In September 2016, in a regional meeting of the inclusive framework of BEPS for non-OECD countries in Latin America and the Caribbean, some participant countries expressed their 'concerns on the consequences derived from not being able to partially or fully implement the BEPS measures contemplated in the inclusive framework, considering their own priorities and specific countries' features'.[26] In addition, in November 2016, in a regional meeting of the inclusive framework of BEPS in African French speaking (non-OECD) countries, the participating countries expressed their need for capacity building and training.[27] These countries also highlighted the importance of finding out the costs and benefits that the implementation of BEPS Actions will cause in their domestic revenue and the need of these countries to maintain some of their preferential tax regimes in order to attract investment.[28] Furthermore, these countries asked for more flexibility in the time schedule and on the methodology to be used to implement the BEPS minimum standards.[29] If the BEPS Inclusive Framework does not take into account these shortcomings, the consequences will be a partial implementation of BEPS or an implementation of BEPS in theory but in practice a lack of commitment to the BEPS.

1.1.9 Different Perspectives on Fairness

Different perspectives on fairness between developed and developing countries will influence the implementation of the BEPS Actions including the BEPS Multilateral instrument. In light of the BEPS Project as well as the need of developing countries to raise revenue to ach-

22. I.J. Mosquera Valderrama, 'Legitimacy and the Making of International Tax Law: The Challenges of Multilateralism', 7 *World Tax Journal* 3, 343, at 382 (2015).
23. *See* <www.oecd.org/tax/beps/inclusive-framework-on-beps-composition.pdf> (last visited 22 March 2017).
24. M. Moore, H.O. Fjeldstad, J. Isaksen, O. Lundstøl, R. McCluskey & W. Prichard, 'Building Tax Capacity in Developing Countries', 96 *IDS Policy Briefing, Institute of Development Studies* (2015).
25. The UN has addressed the BEPS issues from the perspective of developing countries. For this purpose, a questionnaire on BEPS issues was made available also including background papers drafted by legal scholars regarding specific topics. The responses to the questionnaire by developing countries were limited since only Lesotho, Ghana, Tonga and Zambia provided short answers to the questionnaire. Two of the main issues that these countries addressed were the implementation of domestic rules and the administrative capacity. In respect of implementation of domestic rules the countries mentioned the introduction of guidelines to apply the arm's length principle in transfer pricing (Tonga); implementation of tax avoidance rules (Zambia); lack of database to conduct the comparability analysis in respect of transfer pricing (Ghana); to prevent the tailoring of activities by multinationals so that such activities will not be deemed to constitute a permanent establishment in the developing country (Zambia). In respect of administrative capacity, Lesotho made reference to the limited skills to audit some of the highly specialised sectors. *See* Valderrama (2015), above n. 7, 615, at 619.
26. Regional meeting of the Inclusive Framework on BEPS for Latin America & the Caribbean. Montevideo, Uruguay, 21-23 September 2016. Co-chair summary, at 3; *see* <www.oecd.org/tax/beps/beps-regional-meeting-co-chairs-summary-lac-september-2016-montevideo.pdf> (last visited 22 March 2017).
27. OECD and CREDAF hold regional meeting of the Inclusive Framework on BEPS for francophone countries; *see* <www.oecd.org/ctp/oecd-holds-regional-meeting-of-the-inclusive-framework-on-beps-for-francophone-countries.htm> (last visited 22 March 2017).
28. Chair summary 4; *see* <https://www.oecd.org/fr/fiscalite/beps/resume-co-presidents-reunion-regionale-du-cadre-inclusif-beps-tunis-2016.pdf> (last visited 22 March 2017).
29. *Ibid*. Chair summary conclusion.

ieve the SDGs,[30] this article aims to provide a discussion of the concept of fairness in respect of developing and developed countries implementing the BEPS Actions. This article aims to answer the following questions: Is the perception of fairness between developing countries and developed countries the same or different? And if different, what, if anything, can be done to achieve fairness for both developed and developing countries?

This article does not aim to provide a definition of fairness.[31] The focus of this article is on the approach to fairness from an international perspective, *i.e.* fairness between the states. Whether and how the BEPS Project and Action Plan will contribute to fairness from the perspective of justice in the BEPS 44 group and in developing countries that are participating as BEPS Associates in the BEPS Inclusive Framework is not clear. To our best knowledge, no research report on this issue is available.

1.1.10 Structure and Limitations

We first address the shortcomings of the BEPS project in respect of developing countries addressed by tax scholars and by international organisations (Section 2). Thereafter, we offer some arguments on why developing countries might perceive fairness in relation to corporate income taxes differently from developed countries (Section 3). Subsequently, we provide some examples of policy issues where the issue of fairness should be addressed more profoundly and in a broader context on the international BEPS-agenda than thus far, where the OECD's and EU's focus was on achieving a level playing field and voluntary compliance (Section 4).

30. In their Global Framework for Financing Development Post-2015 Program the Heads of State and Government and High Representatives gathered in Addis Abba from 13 to 16 July 2015 recognised 'that significant additional domestic public resources, supplemented by international assistance as appropriate, will be critical to realizing sustainable development and achieve the SDGs'. Furthermore, they committed to 'enhance revenue administration through modernised, progressive tax systems, improved tax policy and more efficient tax collection'; and to 'work on improving the fairness, transparency, efficiency and effectiveness of their tax systems, including by broadening the tax base and continuing efforts to integrate the informal sector into the formal economy in line with country circumstances'; *see* <www.un.org/esa/ffd/ffd3/wp-content/uploads/sites/2/2015/07/Addis-Ababa-Action-Agenda-Draft-Outcome-Document-7-July-2015.pdf> (last visited 22 March 2017).
At the United Nations Sustainable Development Summit on 25 September 2015, world leaders adopted the 2030 Agenda for Sustainable Development, which includes a set of 17 Sustainable Development Goals (SDGs) to end poverty, fight inequality and injustice, and tackle climate change by 2030; *see* <www.undp.org/content/undp/en/home/sdgoverview/post-2015-development-agenda.html> (last visited 22 March 2017).
31. Fairness from a conceptual and an institutional perspective will be the subject of another article from these authors. *See* 'Fairness: A Dire International Tax Standard with No Meaning?' (forthcoming).

2 Shortcomings of BEPS in Respect of Developed and Developing Countries

2.1 Introduction

Are the BEPS Actions truly the best option for creating a level playing field for and voluntary compliance by their companies? Some developed countries have expressed their concerns and have decided to act unilaterally by introducing their own rules. An example of the former is the United States where the Congress has expressed concern in the negotiation of a BEPS Multilateral Instrument, stating that 'regardless of what the Treasury Department agrees to as part of the BEPS project, Congress will craft the tax rules that it believes work best for U.S. companies and the U.S. economy'.[32] The latter has been the case in Australia and the United Kingdom, two countries that have decided to introduce their own (domestic) rules to deal with shifting of profits by multinationals (*i.e.* diverted profit tax). The introduction of these unilateral measures shows the lack of commitment to the consensual approach of BEPS.

Australia's and the United Kingdom's unilateral initiatives have received criticism from the Director of the OECD's Centre for Tax Policy, stating that 'what is clear is that without coherent, global approaches, problems like those that gave rise to BEPS are likely to arise again – it is the mismatches and gaps between national tax systems, along with the international rules, that have facilitated these types of tax planning arrangements and allow the location of taxation to be separated from the underlying economic activity. To effectively maintain their tax sovereignty in a globalised world, governments can no longer just consider their domestic system if they want their tax policies to be effective.'[33] To the authors' knowledge, no other country has introduced similar taxes.[34]

In this context, the question that should be asked is if these developed countries (members of the OECD and of the G20) have concerns on the likeliness that the BEPS proposals will be accepted and/or whether these

32. Letter of the Senate Finance Committee (Chairman Orrin G. Hatch) and House Ways and Means Committee (Chairman Paul D. Ryan) to the Secretary of the Treasury Jacob Lew of 9 June 2015; *see* <https://www.finance.senate.gov/chairmans-news/hatch-ryan-call-on-treasury-to-engage-congress-on-oecd-international-tax-project> (last visited 22 March 2017).
33. Interview to OECD Pascal Saint-Amans March 2016; *see* <https://taxlinked.net/blog/march-2016/beps-oecd-pascal-saint-amans-answers-questions>.
34. However, another tax that could also have issues of fairness is the recently (2016) proposed Equalization Levy to impose tax on specific digital transactions. This levy aims to allocate a 'fair share' on the tax of the income obtained in digital transactions. It is not yet clear whether this Equalization Levy will be approved by the Legislative and if it will survive the constitutional challenge in India. It is also not clear how the tax treaties will provide relief to this levy since this levy does not form part of the Indian Income Tax Act of 1961. *See*, for an analysis of this levy, S. Wagh, 'The Taxation of Digital Transactions in India: The New Equalization Levy', 70 *Bulletin for International Taxation* 9 (2016).

proposals will be effective. As rightly stated by Ostwald, the question is 'who will adopt the BEPS after all?'[35]

In respect of developing countries that were outside the BEPS 44 Group and therefore did not participate in the decision-making process of the BEPS Action, this question is even more valid. Will developing countries adopt BEPS? And if so, how will the shortcomings of BEPS agenda and Actions in respect of developing countries be solved?

The development of a multilateral instrument and the introduction of an inclusive framework for the implementation of BEPS calls for the OECD and G20 to address the shortcomings of BEPS in respect of developing countries. These shortcomings are addressed in the following paragraphs. In Section 4 we provide some thoughts for further research on the fairness of BEPS vis-à-vis developing countries.

2.2 Different Needs Identified by the Four IOs and Scholars

2.2.1 Different Needs of Developing Countries Identified by the Four IOs

As has been mentioned, the OECD recognises in its Report to G20 Developing Working Group on the Impact of BEPS in Low Income Countries that developing countries have other needs than developed countries in respect of both tax design and tax administration, and that the BEPS issues may manifest differently for developing countries given the specialties of their legal and administrative governing framework. Specific concerns that have been identified in the OECD's questionnaire and consultations and the IOs' experiences are: Tax loss on indirect transfer of assets; Lack of data for transfer pricing comparability analyses; Wasteful tax incentives that erode the tax base; and capacity development issues involving international assistance providers. Amongst others, IMF, UN and World Bank addressed these issues.[36]

In 2014, the IMF published a Policy Paper on the Spillovers in International Corporate Taxation.[37] In that paper, the IMF addressed the issue of tax incentives as one of the reasons for corporate tax spillover being the impact that one country's international tax practice has on other countries. The IMF stated that for developing countries, the key issues are preventing tax treaty shopping, indirect transfer of interest in assets, interest deductibility and the introduction of clear and simplified transfer pricing rules.[38]

In July 2015, following the invitation of the G20's Development Working Group the IMF, the OECD, the UN and the WB published a report with options for low-income countries' effective and efficient use of tax incentives for investment.[39] This report provided recommendation on how support for developing tax capacity in developing countries can be improved. This report also identified other problems of developing countries, which include non-BEPS issues, that may result in tax base erosion or may reduce compliance. These problems are besides the use of tax incentives, the lack of technical and administrative capacity, and corruption. Some problems can be solved by means of technical assistance but others will need the political will for instance to tackle corruption, and to reduce or control the excessive use or length of tax incentives by developing countries.

This shows that international organisations are aware of the fact that the needs of developing countries are to some extent different from those of developing countries, as reflected in the OECD's Addressing the impact of BEPS in Low Income Countries Report (2014) and also argued by IMF (2014) and the July 2015 Report. Developing countries feel the scope of the BEPS discussion should be broadened to the use of tax incentives, the allocation of tax treaty rights in accordance with residence and source, the tax treaty costs/benefits analysis to be made for the negotiation of tax treaties, the finding of comparables for the application of transfer pricing rules and the limited administrative capacity of tax administration.

2.2.2 Needs of Developing Countries Identified by Scholars

Scholars also pointed out the differences in needs between developed and developing countries.

Wagenaar has rightly argued that some of the BEPS problems may not be relevant for developing countries and that, therefore, 'the proposed solutions could also have unexpected results in tax systems'.[40] Wagenaar referred to specific issues in developing countries such as tax holidays, tax exemptions, reliance on source-based taxation, use of deemed profit regimes and the legal restrictions on activities by foreign investors that may restrict 'foreign companies to operate and structure transactions in certain ways'.[41]

This concern has also been shared by Oguttu in a two-part article regarding the analysis of BEPS Actions from

35. T.P. Ostwal, 'Who Will Adopt the OECD's Plan against BEPS, after All?', *Kluwer International Tax Blog* (2015); *see* <http://tpostwal.in/downloads/OECDs.pdf> (last visited 22 March 2017).
36. As acknowledged in OECD (2014), above n. 9, at 20.
37. IMF Policy Paper Spillovers in International Corporate Taxation, International Monetary Fund, Washington, DC, 9 May 2014.
38. *Ibid.*, at 24.
39. 'Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment'. A report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank (September 2015), at 23; *see* <https://www.imf.org/external/np/g20/pdf/101515a.pdf> (last visited 22 March 2017).
40. L. Wagenaar, 'The Effect of the OECD Base Erosion and Profit Shifting Action Plan on Developing Countries', 69 *Bulletin for International Taxation* 2, 84, at 86 (2015).
41. For instance, Wagenaar explains that the 'setting up activities often requires business licences that restrictively list the activities that can be performed by the foreign investor. In addition, there may be obligations to register or get approval for any cross-border contracts that have been entered into by local subsidiaries. Extracting cash from operation companies may require special approvals under foreign exchange control or more general rules controlling foreign investment'. *Ibid.*, at 87.

an African perspective.[42] For Oguttu, 'protecting the tax base of African countries involves adopting relevant provisions in their domestic laws and in the tax treaties that they conclude and, at the same time, being aware of the special needs and perspectives of the country in question, such as the state of development of the tax system and its administrative capacity'.[43] According to Oguttu, the Actions that are important for African countries are – in line with the OECD's findings for its Low Income Report – Action 4, 6, 7, 10 and 13, and, remarkably different from the OECD's findings, not 11 but 12.[44]

In another article Oguttu addressed the problems in the implementation of the mutual agreement procedure, MAP (Action 14) and the role of the competent authorities (CA) in African countries. Oguttu argued that the OECD 'has issued a number of documents providing guidance regarding the effectiveness of MAPs'. However, the OECD's recommendations often favour the OECD member countries, which may not take into account the interests and administrative constraints of developing countries'. Therefore, Oguttu recommends that in line with international guidance on effective MAPs that has been provided by the minimum standards set out in the Final Report on Action 14 and the UN Guide on MAPs for developing countries, African countries should publish clear guidelines and procedures to access MAPs that clearly specify the circumstances in which MAPs will be applied, the time limits in which taxpayers can approach the CAs, who is the CA, what documentation is required to be submitted with the application for a MAP, the interaction of MAPs with domestic legislation and estimated timelines.[45]

Lennard[46] refers to the tension between source- and residence-based taxation on one hand, and the importance of withholding taxes to many countries on the other, but also the issues it raises for taxpayers. As to Mosquera for developing countries, issues that should be addressed, which are not BEPS-related issues, are 'the transparency in respect of the extractive industry, the consequences of the repeal of tax incentives in respect of the bilateral investment treaties, the training required for tax treaty negotiations, and the usefulness (or not) of a multilateral instrument to modify tax treaties for countries that are at the early stages of concluding tax treaties'.[47]

Burgers *et al.* discussed the fact that BEPS issues may not be similar in developing countries as in developed countries and recommends developing countries to take notice of the way tax systems of developed countries have been exploited by taxpayers, among others, in structuring their finance, as well as of the anti-abuse measures that countries with more advanced tax systems have included in their tax systems; to identify to which extent their tax systems might be exploited in a similar way; and to decide on measures to counteract such abuse.[48] The following paragraphs will provide our view on the problems regarding the implementation of the BEPS Actions in developing countries.

2.3 BEPS Actions and Developing Countries

2.3.1 Introduction

The above overview shows that international organisations and tax scholars have concerns regarding whether all BEPS Actions are relevant for developing countries, and on the feasibility of implementing BEPS Actions in developing countries. In this section, we provide our view on the relevance of BEPS Actions for developing countries.[49] This description is by no means exhaustive. The focus is on the four BEPS Actions (5, 6, 13 and 14) regarded as minimum standards with some succinct reference to the other BEPS Actions. Further research is recommended on the feasibility of the implementation of the BEPS Actions considering the differences in tax systems and tax cultures of countries around the world

42. A.W. Oguttu, 'OECD's Action Plan on Tax Base Erosion and Profit Shifting: Part 1 – What Should Be Africa's Response?', 69 *Bulletin International Taxation* 11 (2015) and *see* A.W. Oguttu, 'OECD's Action Plan on Tax Base Erosion and Profit Shifting: Part 2 – A Critique of Some Priority OECD Actions from an African Perspective – Addressing Excessive Interest Deductions, Treaty Abuse and the Avoidance of the Status of a Permanent Establishment', 70 *Bulletin International Taxation* 6 (2016).
43. *Ibid*.
44. Dealing respectively with limit base erosion via interest deductions and other financial payments, prevent treaty abuse, prevent artificial avoidance of permanent establishment, transfer pricing, disclosure of aggressive tax planning and transfer pricing documentation.
45. For developing countries, more specifically African countries, this author states that 'African countries need to ensure that MAPs function effectively, and that MAPS are transparent and accessible to taxpayers. African tax administrations should set aside funds to train their staff regarding MAPs. They should also be more active in supporting taxpayers who apply for MAPs and should not try to influence taxpayers to give up their right to MAPs, and taxpayers should not be prohibited, as part of settlement negotiations with tax administrations, from claiming the full amount of tax suffered in exchange for not proceeding with a MAP'. A.W. Oguttu, 'Resolving Treaty Disputes: The Challenges of Mutual Agreement Procedures with a Special Focus on Issues for Developing Countries in Africa', 70 *Bulletin for International Taxation* 12 (2016).
46. M. Lennard, 'Base Erosion and Profit Shifting and Developing Country Tax Administrations', 44 *Intertax* 10, at 745 (2016).
47. *See* Valderrama (2015), above n. 22, 381, at 382.
48. I.J.J. Burgers, J.N. Bouwman, N.J. Schutte & A.J. van Herwaarden, 'Pay your taxes where you add the value: how to avoid tax avoidance and abuse? An overview of measures taken and proposed with a special focus on developing countries'. Paper presented at Pay your taxes where you add the value, The Hague, The Netherlands, 2015: 1-61; *see* <www.rug.nl/research/portal/files/22877769/Pay_your_taxes_where_you_add_the_valuetaxavoidance2900615def.pdf!null> (last visited 22 March 2017).
49. This analysis does not address Action 15, the BEPS Multilateral Instrument. For a discussion on the BEPS multilateral instrument, *see* R. García Antón, 'The 21st Century Multilateralism in International Taxation: The Emperor's New Clothes?', 8 *World Tax Journal* (2016); and *see* N. Bravo, 'The Multilateral Tax Instrument and Its Relationship with Tax Treaties', 8 *World Tax Journal* 3 (2016); *see also* I. Grinberg, 'The New International Tax Diplomacy', 104 *Georgetown Law Journal* 1137, at 1196 (2016).

and the different problems felt by developing and developed countries.[50]

2.3.2 Implementation Problems

The lack of legitimacy in respect of the participation of developing countries in the agenda setting and the content of the BEPS Actions may also have an influence on the implementation of the BEPS Actions in developing countries. This has also been pointed out by Lennard[51] stating that 'even for countries that have not been directly involved in the BEPS process there are aspects of it which may have generally positive domestic and international impacts. However, direct developing country involvement in the decision making process by countries that are neither OECD Members nor G20 countries has been very limited, and there is suspicion among many countries that their engagement on implementation is more zealously sought than their participation in setting the rules, and that those rules may not sufficiently reflect developing countries realities and priorities.'[52]

The BEPS Inclusive Framework has introduced four BEPS Actions as minimum standards that countries participating in this Framework will be required to implement. A peer review system has been introduced to review the legal and tax framework and the implementation of these minimum standards in these countries.[53] These minimum standards are Actions 5, 6, 13 and 14 dealing respectively with eliminating harmful tax regimes, tax treaty abuse, country-by-country reporting requirements, and improvement of the mutual agreement procedure. In our view, developing countries will benefit from all these four Standards. However, for these Actions to be effective, we suggest these Actions should be tailored to developing countries and the problems in the implementation of these standards will need to be further analysed. Below we provide for a short overview of some of these implementation problems.

Action 5: Preferential Regimes Needed to Attract Investment

Action 5 deals with preferential tax regimes that can be qualified as harmful. However, countries need to have preferential tax regimes to attract investment and the question is how these harmful tax regimes will be evaluated, and how this evaluation can be detrimental to developing countries' own tax and investment policy. This concern has been expressed by French African speaking countries addressed in the regional BEPS Inclusive Framework meeting of November 2016 (see Section 1).

Action 5 and 13 Exchange of Business Information: Technical Capacity Problems

Action 5 and Action 13 introduce exchange of business information, the technical capacity of developing countries and the protection of confidentiality will also need to be evaluated. Action 5 introduces compulsory spontaneous exchange on rulings related to preferential tax regime. Action 13 deals with transfer pricing documentation that provides for exchange of documentation such as master file, local file and country-by-country reports among countries. The question that arises is how the confidentiality of the business and taxpayer information exchange in these Actions will be protected in developing and developed countries.[54] Will developed countries introduce safeguards to limit the exchange with countries that do not have the same level of protection of taxpayer information as the developed country? The problems of automatic exchange of information should be addressed taking into account that due to the fast pace in which automatic exchange of information 'is going to take place, the result may be less control over the accuracy and use of the information by the receiving and supplying authorities'.[55]

Action 6 Tax Treaty Abuse: Technical Capacity Problems

Another Action that may be difficult for developing countries to implement is Action 6, which deals with tax treaty abuse. The problems may arise due to the limited technical capacity of developing countries to implement the limitation on benefits rule and/or the principal purpose test. Uncertainty of how tax administrations will interpret the new rules is another issue that is probably more prominent in developing countries than in developed countries.

Action 14 Peer Review of Mutual Agreement: Lack of (Meaningful) MAP-Rules

The final minimum standard to be implemented is Action 14 dealing with mutual agreement procedure. The terms of reference for the peer review has identified four key areas: preventing disputes, availability and access to MAP, resolution of MAP cases, and imple-

50. The differences in tax systems and tax cultures have been addressed in the past by tax scholars considering that the legal transplant of concepts may result in different outcomes due to the differences in tax systems and tax cultures in countries around the world. *See* C. Gabarino, 'Comparative Taxation and Legal Theory: The Tax Design Case of the Transplant of General Anti-Avoidance Rules', 11 *Theoretical Inquiries in Law* 2 (2010); *see also* I.J.J. Burgers, 'Some Thoughts on Further Refinement of the Concept of Place of Effective Management for Tax Treaty Purposes', 35 *Intertax* 6/7, 378, at 386 (2016); *and see* I.J. Mosquera, 'The Interaction of Tax Systems and Tax Cultures in an International Legal Order for Taxation', 5 *Diritto e Pratica Tributaria Internazionale* 2, CEDAM, Italy, 841, at 869 (2008); and *see* I.J. Mosquera, *Leasing and Legal Culture – Towards Consistent behavior in Tax Treatment in Civil Law and Common Law Jurisdictions*, at 352 (2007).
51. Michael Lennard is Chief International Tax Cooperation, United Nations.
52. M. Lennard, 'Base Erosion and Profit Shifting and Developing Country Tax Administrations', 44 *Intertax* 10, 744, at 745 (2016).
53. The OECD has announced that the first standard that will be reviewed and monitored will be Action 14; *see* <www.oecd.org/tax/beps/beps-action-14-peer-review-and-monitoring.htm> (last visited 22 March 2016).
54. *See also* F. Debelva and I.J. Mosquera, 'Privacy and Confidentiality in Exchange of Information Procedures: Some Uncertainties, Many Issues, But Few Solutions', *Intertax*, forthcoming May 2017.
55. *See* Valderrama (2015), above n. 22, 371, at 377.

mentation of MAP agreements.[56] The schedule of peer review has been already published and the peer review of the first batch of countries will start on December 2016.[57] Interesting in this schedule is that the peer review for most of the developing countries has been deferred until 2020.[58] The reason for this deferral is stated in the terms of reference: 'the MAP Forum should defer the review of any such member that is a developing country and is not an OECD or G20 country if that member has not yet encountered meaningful levels of MAP requests and there is no feedback from other members of the FTA MAP Forum indicating that the jurisdiction's MAP regime requires improvement'.[59] This statement acknowledges the lack of MAP rules in developing countries. Surprisingly enough, the terms of reference do not refer to the UN guidelines on mutual agreement procedure, which can be used by developing countries to introduce MAP rules.[60] The question is whether the terms of reference will take into account the technical and administrative constrains of developing countries to introduce MAP rules and to provide an effective solution to tax disputes by means of the MAP. This concern has been also highlighted by Oguttu when addressing the problems in the implementation of MAP rules in African countries (Section 2.2.2).

Other BEPS Actions

Other BEPS Actions, *i.e.* 1-4 and 7-12, are regarded as best practices and recommendations. Due to the space constraint in this article, below we only briefly address the implementation of these Actions in developing countries. In our view, Actions 7 (permanent establishment) and Actions 8-10 (transfer pricing) are more relevant for developing countries.

Action 1 and 4 (respectively digital economy and limitation on interest deductions) can be dealt with in domestic law by levying a tax on digital services or by means of specific targeted anti-avoidance rule in combination with a general anti-avoidance rule. However, we feel, for level playing field reasons, it would be best if all countries introduce more or less similar rules. The different views on equality and certainty discussed in Section 3.2 will also be relevant for the implementation of these Actions.[61]

In respect of the implementation of Actions 2 and 3 (respectively hybrid mismatches and controlled foreign corporation rules) we feel the perception of developing countries expressed in the OECD's Low Income Countries Report Part 1 requires international governance actions in raising the awareness that the use of hybrid mismatches etc. is a global phenomenon.

Action 11, Measuring and Monitoring, BEPS Report, shows that the quantitative analyses of BEPS are severely constrained by limitations of the currently available data. Even the tax data directly controlled by governments is often not made public in a form useful for analysis. Limited government capacity for analysing the data already collected by tax authorities was demonstrated by the fact that only eight out of thirty-seven OECD Member States surveyed by the OECD could report the total amount of tax revenue collected from MNEs in their jurisdictions. Capacity problems as mentioned above are a main concern for developing countries, the reason why it is safe to state that developing countries will perceive even more problems with measuring BEPS than developed countries.[62]

2.4 Inclusiveness and Multilateralism of BEPS

2.4.1 Is BEPS Really Inclusive Providing for Participation on 'Equal Footing'?

Developing countries' 'participation on equal footing' in the discussion of the BEPS Multilateral Instrument and as BEPS Associate in the Inclusive Framework for implementation of BEPS raises the question as to whether the BEPS is inclusive or not.

The OECD seems to be aware of the importance of including developing countries in the discussion on the implementation of BEPS for legitimacy purposes. The OECD reports that, until the release of the BEPS Package in October 2015, approximately 60 developing countries have participated directly or indirectly in the process through regional consultations and thematic global Fora. Despite this participation, developing

56. Terms of reference available at the OECD website; *see* <www.oecd.org/tax/beps/beps-action-14-on-more-effective-dispute-resolution-peer-review-documents.pdf>.
57. These countries are Belgium, Canada, The Netherlands, Switzerland, the United Kingdom and the United States.
58. The countries for which peer review has been deferred until 2020 are Benin, Costa Rica, Egypt, Gabon, Georgia, Jamaica, Kenya, Pakistan, Paraguay, Senegal, Seychelles, Uruguay; *see* <https://www.oecd.org/tax/beps/beps-action-14-peer-review-assessment-schedule.pdf>.
59. OECD, *BEPS Action 14 on More Effective Dispute Resolution Mechanisms – Peer Review Documents, OECD/G20 Base Erosion and Profit Shifting Project* (2016), at 20; *see* <www.oecd.org/tax/beps/beps-action-14-on-more-effective-dispute-resolution-peer-review-documents.pdf>.
60. *See*, on the use of these guidelines for African countries, Oguttu; *see* <www.un.org/esa/ffd/tax/gmap/Guide_MAP.pdf> (last visited 22 March 2017).
61. *E.g.* JinYan Li in her paper 'Protecting the Tax Base in the Digital Economy' written at the request of the UN. She points out the digital economy poses two kinds of challenges to the tax base of developing countries: base erosion due to BEPS strategies; and base cyberization due to the dematerialisation and connectivity features of the digital economy. According to Li, developing countries may need to develop their own measures, such as the taxation of services and royalties, as developing countries, being market countries, tend to be 'net losers' in tax revenue. Li calls for coordination between the UN and the OECD, as the special concerns of the developing countries may not be shared by the OECD. A. Trepelkov, H. Tonino & D. Halka, *United Nations Handbook on Protecting the Taks Base of Developing Countries* (2015) 3; *see* <www.un.org/esa/ffd/wp-content/uploads/2015/07/handbook-tb.pdf> (last visited 22 March 2017). For the participation and representation of developing countries and the role of the UN *see* R.S. Avi-Yonah and H. Xu, 'Evaluating BEPS', *University of Michigan Public Law Research Paper* No. 493 (15 January 2016); *see* <http://ssrn.com/abstract=2716125> (last visited 22 March 2017) (discussed in Section 2.3 hereafter).
62. OECD, *Measuring and Monitoring BEPS, Action 11 – 2015 Final Report* (2015), at 37; *see* <http://dx.doi.org/10.1787/9789264241343-en> (last visited 22 March 2017).

countries did not have a decision-making role in the setting of the BEPS agenda nor in the content of the BEPS Actions. The decision-making process was at the hand of the BEPS 44 group, and of course developing countries did not participate, nor were represented, in setting the agenda and in the decision-making process of the BEPS Action Plan that resulted in the 5 October BEPS final package.[63] Following concerns of legitimacy, the OECD wanted to change this by introducing the participation on equal footing (thus also decision making) in the BEPS Multilateral Instrument (more than 100 countries including the BEPS 44 group) and in the BEPS Inclusive Framework (90 countries including the BEPS 44 group).

Although the OECD refers to the participation as being on 'equal footing', given developing countries are latecomers in the discussion, they have little capacity and probably also less knowledge on the topic than developed countries that this gives a too optimistic view of reality. Moreover, the participation in the discussion of the multilateral instrument and in the inclusive framework will not solve the problem of the lack of participation of developing countries in the setting of the agenda and the content of the BEPS Actions. The OECD's and other international organisations' acknowledgment of the different objectives demonstrates that even though the OECD and other international organizations are aware of the differences, these differences did not result in a tailor-made Action Plan for developing countries nor in specific caveats or options in the BEPS Actions to be applicable to developing countries.

This is more important if we are to consider the BEPS multilateral instrument, which modifies bilateral tax treaties around the world.[64] Even though there is consensus for a multilateral agreement, as rightly stated by Eicke it is not clear whether the time will be right and 'how many compromises and mini package deals will be necessary to achieve an agreement that does not sacrifice the higher goals'.[65] The BEPS multilateral instrument adopted in November 2016 confirms this statement since it provides several options for countries to adopt for instance in respect of the method to prevent double taxation in hybrid mismatches and on the content of the provision dealing with treaty abuse.[66] Countries will be required to revisit their tax treaties to find out which country will introduce which option, and then to start making the changes accordingly. This requires tax technical knowledge and treaty negotiation skills since the implementation of the option will need to be discussed in the domestic ratification procedure as well as with the other treaty partner.[67]

2.4.2 Should the UN Take Leadership?

The limited inclusiveness and participation of developing countries in the BEPS project have been argued by Reuven Avi-Yonah and Haiyan Xu referring to: (i) the OECD countries dominating the discussion and negotiations; (ii) (at the time) only 60 countries participating in the BEPS discussions in contrast to the UN representing 193 countries); (iii) there is no evidence that the proposals of developing countries that where consulted regarding the BEPS Action Plan were accepted; (iv) the limited influence of developing countries due to the limited experience and resources to enforce the BEPS Actions; and (v) the process of public debate and consulting being insufficient and without transparency since no publication has been made on the reasons for rejecting different proposals. Therefore, as to these authors the UN should take the leadership since the UN is 'more qualified, impartial, transparent, credible and influential than the OECD/G20 in rewriting and renovating the international tax rules including the BEPS counter-measures'.[68]

63. *See* Valderrama (2015), above n. 22, 371, at 377.
64. The explanatory statement explains the way that the bilateral and regional tax treaties will be modified with the BEPS Multilateral instrument stating that 'The Convention operates to modify tax treaties between two or more Parties to the Convention. It will not function in the same way as an amending protocol to a single existing treaty, which would directly amend the text of the Covered Tax Agreement; instead, it will be applied alongside existing tax treaties, modifying their application in order to implement the BEPS measures. As a result, while for internal purposes, some Parties may develop consolidated versions of their Covered Tax Agreements as modified by the Convention, doing so is not a prerequisite for the application of the Convention. As noted below, it is possible for Contracting Jurisdictions to agree subsequently to different modifications to their Covered Tax Agreement than those foreseen in the Convention'.
65. R. Eicke, 'A BEPS Multilateral Instrument – Practical Solution or Elusive Pipe Dream?', *Tax Notes International* (2014), at 528.
66. *See* text of the Multilateral Instrument Arts. 3-7 (Hybrid mismatches) and 7 (treaty abuse). The text of the BEPS Multilateral Instrument is available at the OECD Website; *see* <www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf.
67. The Explanatory Statements states that para. 4 of Art. 29 Time Notifications 'provides that if notifications are not made at the time of signature, a provision al list of expected notifications shall be provided to the Depositary at that time. This provisional list is for transparency purposes only and is intended to give other Signatories a preliminary indication of the Signatory's intended position. This takes account of the nature of the Convention which will operate to modify existing bilateral or multilateral relationships and the options chosen by the other Contracting Jurisdictions will determine the way in which the existing bilateral or multilateral agreement is modified. Accordingly, provisional indications of intended positions are important to allow an understanding of the likely changes to an existing tax agreement and to facilitate domestic ratification procedures as well as to prepare for the implementation of the modifications made by the Convention. The provisional list of expected notifications under Art. 29(4) does not restrict the ability of that Signatory to submit a modified list of notifications upon deposit of the instrument of ratification, acceptance or approval', at 73; *see* <www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf>.
68. Avi-Yonah and Xu, above n. 61, at 27-28.

The Civil Society Forum[69] and the 134 members of the G77 group of developing countries[70] proposed to give to the UN Tax Committee the status of an intergovernmental body both at the July 2015 Addis Ababa Conference and the July 2016 Nairobi Conference.[71] The Civil Society Forum advocated for a forum where every country can participate, not just the richest. The Civil Society Forum stated in the declaration that 'a key reason why the global tax system has failed is that more than half of the world's countries are currently excluded from the decision-making process on global tax standards". Therefore, the Civil Society Forum stressed that 'we need to fundamentally change the tax rules, and not having every country represented in writing those rules to make sure they work for everyone is not only undemocratic but also unfair'.[72] The G77 developing countries called, as a precondition, for more cooperation in international tax matters 'a more inclusive mode of discussion and a seat at the table in the policy decision making on financing for development'.[73]

Despite these arguments, the proposals were rejected. Developed countries decided not to give the upgrade to the UN Committee since in their opinion the OECD has a leading role in all tax issues. Therefore, it is submitted that the work of the UN Committee as a representative of developing countries will be limited due to the predominant role of the OECD. Another reason is also the UN Committee's lack of resources to engage permanent staff to carry out tax research and/or to advise developing countries.[74] Notwithstanding these problems, in our view the UN should have a more predominant role and international institutions and the OECD, IMF and World Bank should facilitate this role. The initiative of writing Joint Reports is a first step in this direction, that will not only give the UN a more prominent role, but will also contribute to mutual understanding. Our recommendation is provided in Section 4.

2.5 Tax Cooperation vs. Tax Competition

The reason why developing countries are participating in the BEPS project even though its content has been decided by the BEPS 44 group is not clear, but perhaps some indication could be found, for instance, in the need of countries to receive technical assistance and to gain more specialised knowledge on transfer pricing. The motivation for cooperation between states can also be found in the concept of global justice of Nagel,[75] where the transformed role of the state has been addressed.[76] Nagel discusses the problem of how global justice can be achieved. He argues that 'global justice requires global sovereignty' and that 'the most likely path toward some version of global justice is through the creation of potentially unjust and illegitimate global structures of power that are tolerable to the interests of the most powerful current nation-states'. These effective but illegitimate institutions, to which the standards of justice apply, will first increase injustice.

For Dagan – referring to Nagel – the questions that should be asked in international tax and the achievement of global justice are: 'if states' coercive power is eroding due to competition and if they now find it difficult to treat their citizens justly, what, if anything, can be done to promote justice? Can we still expect states to uphold principles of justice even if they can no longer do so unilaterally? Can we expect them to cooperate in order to ensure justice? And if they have to rely on the cooperation of other states in order to sustain their sovereign power, does this give rise to a new level of justice duties, across state boundaries?'[77] In this context, Dagan addresses the shortcoming of the current BEPS Project in the promotion of global justice, which has 'not centered on considerations of justice but, rather, on ways to improve states' ability to collect taxes in light of increasing tax competition', reason why a new way to promote cooperation with justice for all states should be promoted.[78]

For developing countries, the fundamental question is whether in order to raise revenue the solution is interna-

69. According to its website, an open forum for people to engage with the challenges of building a world where all can flourish; *see* <http://civilsocietyforum.com/> (last visited 22 March 2017).
70. A group of, at the date of establishment (15 June 1964), 77 and presently 134 developing countries providing the means for the developing world to articulate and promote its collective economic interests and enhance its joint negotiating capacity on all major international economic issues in the United Nations system, and promote economic and technical cooperation among developing countries; *see* <http://schemaroot.org/region/international/government/united_nations/group_of_77/> (last visited 22 March 2017).
71. 14th session of the UN Conference on Trade and Development (UNCTAD 14) in Nairobi; *see* <www.ipsnews.net/2016/08/developing-nations-seek-tax-body-to-curb-illicit-financial-flows/> (last visited 22 March 2017).
72. In its declaration form, the Addis Ababa Civil Society Forum on Financing for Development of 12 July 2015, the Civil Society states: 'We reiterate the need and strongly recommend the establishment of an intergovernmental, transparent, accountable, adequately resourced tax body with universal membership that leads global deliberations on international tax cooperation. Such a body will strengthen the ability of developing countries to generate significant sustainable financing for development through, for example, combating corporate tax dodging in developing countries and balancing the allocation of taxing rights between source and residence countries. It should also support the efforts of peoples in developing countries to develop their own progressive, rights-based, equitable tax systems and laws, free of such pressures imposed by lenders and developed country governments', at 4; *see* <www.icae2.org/images/Addis%20Ababa%20CSO%20FfD%20Forum%20Declaration%20-%2012%20July%202015.pdf> (last visited 22 March 2017).
73. UN News Centre, 14 July 2015: UN Negotiations resume on financing framework to advance global development; *see* <https://www.theguardian.com/global-development-professionals-network/2015/jul/15/addis-ababa-talks-risk-deadlock-over-un-agency-for-tax-ffd3-financing-for-development> (last visited 22 March 2017).
74. This is illustrated by the fact that only one person is permanent staff of the UN Tax Committee, *i.e.* Michael Lennard. The other participants are members of an Ad Hoc Committee. For an overview of the Committee *see* <www.un.org/esa/ffd/tax/overview.htm> (last visited 22 March 2017).
75. T. Nagel, 'The Problem of Global Justice', 33 *Philosophy & Public Affairs* 2, at 113 and 120 (2005).
76. *Ibid.*, at 146-47.
77. T. Dagan, 'International Tax and Global Justice', *SSRN* (2016), at 24; *see* <http://ssrn.com/abstract=2762110> (last visited 22 March 2017).
78. *Ibid.*

tional tax cooperation and the implementation of BEPS Actions or rather to have tax competition by introducing incentives to attract investment? To answer this question and to give a voice to developing countries, the World Bank organised in May 2016 the Conference: 'Winning the Tax Wars: Global Solutions for Developing Countries.'[79] In respect of corporate taxation,[80] the discussion in this conference addressed philosophical (and political) questions concerning fair and effective taxation from an international perspective. The World Bank states that: 'the global tax agenda has mainly focused on these issues from the fiscal revenue generation perspective (tax base erosion and tax rate "race to the bottom") and efficiency viewpoint (uncertainty of tax regimes for foreign direct investment and long term profitability of firms). Less attention has been given to how these tax trends are affecting developing countries and who the winners/losers are at the global level.'[81]

The topics discussed in this conference were, among others, tax competition, tax cooperation and transparency from the perspective of developing countries, also including questions such as (i) how tax competition affects particularly the ability of developing countries to enforce a legitimate contract between government and taxpayer; (ii) how global tax rules could be improved to keep pace with a rapidly changing global business environment; (iii) whether tax competition is needed; and (iv) whether tax cooperation including possible regional and global arrangements is necessary. The debate on these topics has been made available in the World Bank website and it is clear that the World Bank wants to take a leading role in the debate regarding developing countries.[82] However, it is not yet clear how the findings of this conference will result in concrete proposals for developing countries.

How for instance should the new international regime for exchange of information be accommodated to the needs of developing countries? According to Urinov, a closer study of the global standard, its adoption process and the recent practice indicate that the initiative on automatic exchange of information are intended to establish a platform for regular flow of information mainly between tax havens and some developed countries. It, by and large, ignores the developing countries' participation in the new regime. Urinov warns that in fact, some strict requirements of the standard would prevent most developing countries from joining the regime anytime soon.[83]

2.6 Intermediate Conclusion

In Section 2 we have addressed the shortcoming of BEPS in respect of developing countries. Scholars have addressed mainly the different problems of developing countries, which are not all BEPS-related problems (*e.g.* tax incentives), the lack of participation and representation of developing countries in the decision-making process of the BEPS Actions, and the limited participation of the UN in the BEPS discussions. International organisations such as the IMF, UN and WB have also addressed the importance to help developing countries to strengthen their tax systems and to achieve Sustainable Development Goals (SDGs), to tackle corruption and to give a voice to developing countries, including small countries, into the debate on international policy.

Another problem that has been identified by scholars and international organisations is the allocation of taxing rights between developing and developed countries. The OECD has stated in the 2014 Report that the allocation of taxing rights between countries is outside the scope of BEPS.[84] However, in our view and as rightly argued in legal scholarship,[85] this issue should be also in the BEPS Agenda since only a comprehensive discussion will contribute to achieving fairness in the BEPS discussion in respect of developing countries.

We submit that the implementation of BEPS will require more than the options provided in the Multilateral Instrument. Tailored solutions should be introduced for developing countries, taking into account the lack of technical resources (personnel capacity, technical knowledge and economic means) of developing countries. As rightly argued by Bird, the need for tailored solutions in tax policy also 'emphasizes the extent to which sustainable reforms must be developed "in house" by countries themselves'.[86] Thus, more resources, more time and more tailored solutions are needed for developing countries.

79. Program of the conference; *see* <www.worldbank.org/en/events/2016/04/29/winning-the-tax-wars-global-solutions-for-developing-countries#2.
80. Other topics also discussed are taxing to promote public goods, tobacco taxes, taxing to promote public goods, carbon taxes.
81. Invitation to the conference available at the website of the World Bank; *see* <www.worldbank.org/en/events/2016/04/29/winning-the-tax-wars-global-solutions-for-developing-countries#1>.
82. *See* <http://live.worldbank.org/winning-the-tax-wars> (last visited 22 March 2017).
83. V. Urinov, 'Developing Country Perspectives on Automatic Exchange of Tax Information', 1 *Law, Social Justice & Global Development Journal* (2015), Warwick School of Law Research Paper; *see* <http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2684111> (last visited 22 March 2016).
84. OECD (2014), above n. 9, at 1 and 9; *see* <https://www.oecd.org/g20/topics/taxation/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf> (last visited 22 March 2017).
85. *E.g.* M. Lennard, 'Base Erosion and Profit Shifting and Developing Country Tax Administrations', 44 *Intertax* 10, at 745 (2016); and *see* S.B. Law, 'Base Erosion Profit Shifting – An Action Plan for Developing Countries EPS', 68 *Bulletin for International Taxation* 1 (2014); *see also* Y. Brauner, 'BEPS: An Interim Evaluation', 6 *World Tax J*, at 10-39 (2014).
86. R. Bird, 'Taxation and Development: What Have We Learned from Fifty Years of Research?', *DIIS Working Paper International Development Studies* (2013); *see* <https://www.ids.ac.uk/files/dmfile/Wp427.pdf> (last visited 22 March 2017).

3 Arguments Why Developing Countries Might Perceive Fairness in Relation to Corporate Income Taxes Different from Developed Countries

In a 2003 World Bank publication, Richard M. Bird and Eric M. Zolt mapped arguments why fairness concerns in developing countries may be different from those in developed countries in respect of individual income taxes, wealth taxes and consumption.[87]

There is some evidence that developing countries perceive differently from developed countries the fairness in relation to corporate income taxes as well. In the following we give a few examples of likely differences in perception of fairness between developing and developed countries. These examples will be given in accordance with the economic[88] approach to fairness and the juridical[89] approach fairness.

3.1 Differences in Economic Perspective to Fairness

3.1.1 Higher Dependency on CIT as Source of Revenue

Developing countries may perceive fair corporate income taxes from an economic perspective as defined by Adam Smith in his Maxim of Equality (subjects of every State should contribute in proportion to the revenue which they enjoy under the protection of the State) differently from developed countries for several reasons.[90] First, the corporate income tax (CIT) as percentage of GDP in developing countries is much higher than in developed countries, to wit 10% of GDP, where it has been a constant 3% of GDP in the period 1980-2016 in developed countries despite a sharp fall in statutory tax rates from on average 50%-25% in this period. Therefore, developing countries may be for instance more sensitive to BEPS and, as the OECD rightly remarks, given 'developing countries' greater reliance on CIT revenues, the impact of BEPS on these countries is particularly damaging'.[91]

87. Their main arguments were:
    - developing countries are less capable of using the tax system to redistribute income as income and wealth taxes play a relatively small role in the tax structure of developing countries and individual income taxes are merely a wage withholding tax;
    - care must be taken not to complicate individual income taxes;
    - it is likely that the consequences of using individual income taxes for influencing economic behaviour are different in developing countries than in developed countries (work vs. leisure, formal vs. grey/black economy, saving at home vs. portfolio investment outside the country);
    - personal income taxes in developing countries should have a 'threshold' well above average income levels;
    - the most effective way to reduce inequality in many countries seems likely to be through spending programs targeted at the poor.

    Most likely these arguments are still valid. R.M. Bird and E.M. Zolt, 'Introduction to Tax Policy Design and Development', World Bank, at 21-23; *see* <www.gsdrc.org/document-library/introduction-to-tax-policy-design-and-development/> (last visited 22 March 2017).

88. Public finance scholars traditionally have defined fairness in terms of horizontal and vertical equity (the quality of being fair and impartial). Horizontal equity is defined by Musgrave and Kaplow as the requirement that equals be treated alike and both define vertical equity as requiring an 'appropriate' pattern of differentiation among unequals. *See* R.A. Musgrave, *The Theory of Public Finance* (1959), at 160; L. Kaplow, 'Horizontal Equity: Measures in Search of a Principle', 2 *National Tax Journal* (Discussion Paper No. 8 5/85, Harvard Law School), at 139 (1989); *see* <www.law.harvard.edu/programs/olin_center/papers/pdf/Kaplow_8.pdf> (last visited 22 March 2017); quoted by J.R. Repetti and P.R. McDaniel, 'Horizontal and Vertical Equity: The Musgrave/Kaplow Exchange', 10 *Florida Tax Review* 1 (1993), at 607-22; *see* <http://lawdigitalcommons.bc.edu/cgi/viewcontent.cgi?article=1706&context=lsfp> (last visited 22 March 2017).

89. Tax scholars are using the concept of fairness as justice to restrict the behaviour of the taxpayer by claiming the moral duty of the taxpayer to pay their fair share. Some tax scholars have addressed the concept of fairness in respect of the role of the citizen (taxpayer) in a political community. The approach of tax scholars results in fairness between taxpayers who should abstain from engaging in aggressive tax planning. However, one of the drawbacks is that the concept of fairness is used without having a proper definition of what is fairness and how fairness can be achieved. The consequence is that fairness in taxation is a blurred concept that may also, from a juridical perspective, have different meanings. S.J.C. Hemels, 'Chapter 18: Fairness: A Legal Principle in EU Tax Law?', in C. Brokelind (ed.), *Principles of Law: Function, Status and Impact in EU Tax Law* (2014); *See also* S.J.C. Hemels, 'Fairness and Taxation in a Globalized World' (2015); *see* <http://ssrn.com/abstract=2570750> (last visited 22 March 2017). *See also* J.L.M. Gribnau and A.G. Jallai, 'Good Tax Governance and Transparency. A Matter of Ethical Motivation', 6 *Tilburg Law School Legal Studies Research Paper Series* (2016). *See also* R. Happé, 'Fiscale ethiek voor multinationals', 144 *Weekblad fiscaal recht* 7108 (2015), at 944 and 953. *See also* R. Happé, 'Belastingethiek: een kwestie van fair share', *Belastingen en ethiek*, 243 *Geschriften van de Vereniging voor Belastingwetenschap* (2011), at 3-69 and 52-53.

90. In his famous 'Wealth of Nations' Adam Smith formulated the following four Maxims (also referred to as Canons) of Taxation that are necessary for a fair tax system: Maxim of Equality, Maxim of Certainty, Maxim of Convenience and Maxim of Economy. *See* A. Smith, *An Inquiry into the Nature and Causes of the Wealth of Nations* (1904); *see* <www.econlib.org/library/Smith/smWN21.html> (last visited 22 March 2017). *See also* T. Seth, *Canons of Taxation Enunciated by Adam Smith – Discussed!* (1948); *see* <www.economicsdiscussion.net/taxes/canons-of-taxation-enunciated-by-adam-smith-discussed/1948> (last visited 22 March 2017).

91. Press release. First meeting of the new inclusive framework to tackle Base Erosion and Profit Shifting marks a new era in international tax co-operation; *see* <www.oecd.org/ctp/first-meeting-of-the-new-inclusive-framework-to-tackle-base-erosion-and-profit-shifting-marks-a-new-era-in-international-tax-co-operation.htm>. 'Given developing countries' greater reliance on CIT revenues, the impact of BEPS on these countries is particularly damaging'.

3.1.2 *Higher Dependency on Tax Incentives as a Method to Attract Investment*

Tax incentives play a more important role in attracting foreign capital than in developed countries. Instead of a race to the bottom in terms of CIT-rates, in developing countries what IMF authors S.M. Ali Abbas and Klemm refer to as partial race to the bottom takes place, where rates have fallen to almost zero due to these tax incentives.[92] Although States intentionally provide these tax incentives, one may wonder whether Adam Smith's Maxim of Equality is upheld by such tax systems. Moreover, in developing countries the widespread exemptions are often provided in non-transparent ways and with a high degree of discretion.[93] Nevertheless, developing countries may perceive their system as being fair, at it is perceived as the only way to be competitive.

3.1.3 *Different Views on Level Playing Field for the Digital and the Traditional Economy*

Developing countries have other views on what is fair than developed countries. An example is the corporate income tax rates applied to the digital economy referred to by World Bank president Jim Yong Kim.[94] The OECD and EU call for a level playing field for the digital economy and the traditional economy. Developing countries apparently feel it is fair to let the digital sector contribute more than the traditional economy because, perhaps in line with Adam Smith's argument for fairness from an economic perspective, they feel this sector of the economy has a greater ability to pay than the traditional economy, that is, in Adam Smith's perception, 'in proportion to the revenue which they respectively enjoy under the protection of the state'. We could not trace any evidence that this sector indeed has such greater ability to pay, and that this sector is able to receive a larger benefit under the protection of the state than the traditional economy. More research on this issue is needed.

3.1.4 *Different Views on Allocation of Taxation Rights*

Developing countries also have different views on the allocation of taxation rights on business profits. The UN for example did not amend its Model Tax Treaty in line with the new Article 7 OECD. The underlying reason may be fear of loss of revenue as well as fear of complicating the allocation of profits to PEs, if not only internal dealings are part of a transaction with a third party (sales of goods, delivery of services to third party, but all internal dealings including internal loans and internal disposal of know-how) should be rewarded arm's length.

In respect of transfer pricing, developing countries stress the importance of simplicity (the so-called sixth method, which is used in a number of developing countries).[95] The problems in the implementation of BEPS Actions related to transfer pricing have been also pointed out by Espinel taking into account the Colombian experience. Even though Colombia as one of the OECD accession countries has adopted the BEPS Action Plan, the implementation of BEPS Transfer Pricing Actions 8-10 does not 'seem practical or achievable in the short term'. Transfer Pricing Legislation was introduced in the 2004 Tax Reform and substantially amended in the 2012 Tax Reform. Therefore, as rightly argued by Espinel, if a 'country has just finished understanding and/or implementing a transfer pricing regime, how can such a country now begin implementing the outcome of the BEPS initiative? What is in it for them?'[96] The answer is adopting the proposed measures will result in more revenue, but the problem will be that the application of transfer pricing rules will result in more disputes not only affecting the multinationals but also countries. Espinel rightly states that 'disputes are now affecting not only MNEs, but also countries themselves, as tax that is not paid in one jurisdiction is paid in the other'.[97] This concern is more important now since the allocation of taxing rights between residence and source has been left outside the scope of BEPS. Developing countries need to have a competitive treaty network if they are to implement all BEPS proposals and at the same time

92. S.M. Ali Abbas and A. Klemm, 'Partial Race to the Bottom; Corporate Tax Developments in Emerging and Developing Economies'; *see* <https://ideas.repec.org/p/imf/imfwpa/12-28.html> (last visited 22 March 2017). The authors assembled a data set on corporate income tax regimes in fifty emerging and developing economies over 1996-2007 and analysed their impact on corporate tax revenues and domestic and foreign investment.
93. A. Jewell, M. Mansour, P. Mitra & C. Sdralevich, IMF Staff Discussion, 'Fair Taxation in the Middle East and North Africa' (2015); *see* <https://www.imf.org/external/pubs/ft/sdn/2015/sdn1516.pdf> (last visited 22 March 2017).
94. In respect of fair taxation, the World Bank furthermore is concerned with the fact that governments in many developing countries have taxed the ICT sector at rates significantly higher than other services. World Bank president Jim Yong Kim remarked at the World Bank–IMF Spring Meeting 2016 that one of the three possible ways for Ministers of Finance to contribute to the 'Global Connect Initiative's target of 1.5 billion people added to the internet by 2020' is 'Fair taxation of the telecom sector'. 'Governments need to ensure more reasonable and predictable tax levels'. Remarks by World Bank President Jim Yong Kim at the Global Connect Initiative, World Bank-IMF Spring Meetings 2016; *see* <www.worldbank.org/en/news/speech/2016/04/14/remarks-by-world-bank-group-president-jim-yong-kim-at-the-global-connect-initiative>.
95. *See*, for the Sixth Method, OECD, 'Transfer Pricing Comparability Data and Developing Countries' (2014); and M.G. Malla and A. Carrera, 'Commodities Transfer Pricing: Revisiting the Sixth Method in Latin America', 25 *Transfer Pricing Report* 422 (2016).
96. M.I. Espinel Coral, 'BEPS Initiative in Colombia: Transfer Pricing for the Modern World', 23 *International Transfer Pricing Journal* 4, at 318-22 (2016).
97. *Ibid.*, at 322.

want to be able to attract foreign investment.[98] Furthermore, as rightly stated by Wagenaar, restriction of treaty access for instance by introducing the LOB or PPT clause can give 'rise to both domestic and treaty policy questions for developing countries, which should reconsider the appropriate level of taxation on investors from non-treaty states. In the longer run, these countries should consider obtaining similar benefits for local business by expanding their treaty network'.[99]

3.1.5 Different Views about Fair Tax Systems and Fair and Efficient Tax Administrations

In response to the recognition that BEPS is a global problem, the African Tax Administration Forum (ATAF) organised a Consultative Conference on New Rules of the Global Tax Agenda in Johannesburg, on 18 and 19 March 2014. In its Discussion Paper entitled 'The Global Tax Agenda and Its Implications for Africa',[100] ATAF stated that 'in developing countries, beyond its fiscal role, the tax system has a more substantive role: it is an important tool for good governance and the basis for the social fiscal contract between governments and its citizens and corporations. Tax revenues are vital to finance their development agenda and the redistribution of incomes, thus contributing the poverty alleviation. In a context where the recent global financial crisis has reduced the importance of official development assistance (ODA) as a reliable source for financing post-2015 Millennium Development Goals (MDGs), developing countries are beginning to realise that the achievement of the MDGs and economic goals (*i.e.* market reforms, promotion of private sector investment, industrialisation and promotion of regional programmes and development, etc.) will depend heavily on domestic tax revenues. Consequently, creating robust and equitable domestic tax policies and implementing a fair and effective international tax system through international cooperation become primordial.'

ATAF is also concerned about a fair tax design and fair tax administrations, as is reflected in a Joint Statement on Cooperation between the African Development Bank and the African Tax Administration Forum: 'Convinced that taxation is essential to sustainable development, and that all sectors of society should work together to promote fair and efficient tax systems and administrations that will ensure that each country receives the fruits of its own economic achievement and, at the same time, improves its overall governance'.

The concerns of ATAF are important since these type of organisations are one of the three pillars[101] of the OECD in translating the BEPS Action Plan into practical support for lower capacity developing countries. ATAF's concerns in the context of 'The Global Tax Agenda and its implications for Africa' show the BEPS Multilateral instrument and the BEPS Inclusive Framework should ensure that each country including developing country benefits from BEPS by raising more revenue, acquiring more technical expertise or by receiving a part of the revenue that the other country has obtained in part due to the efforts of the country.

3.2 Differences in Juridical Perspective to Fairness

3.2.1 Equality: Groups of Companies

One of the issues of fairness from a juridical perspective is equality. Developing countries may have different ideas about equality compared to developed countries in respect of the design of CIT law, especially where it concerns groups of companies. Like many other developing countries, Tanzania, for example, abolished the participation exemption in Section 54(2) of the Income Tax Act 2004 as from July 2012, as it was considered not fair that contracts were not respected. Tanzania for the same reason does not have a group treatment regime.[102]

Developing countries generally also have other perceptions on the juridical fairness of withholding taxes, not in the least also for the economic reason that withholding taxes are simple and reliable sources of revenue. Often developing countries have high withholding taxes on all three sources of passive income (dividend, interest and royalties). An exception is Colombia, a country that does not levy dividend withholding tax at the time of writing (November 2016). The Colombian government proposed in its 2012 Tax Reform Bill introduction of a 4% tax on dividends. There was opposition from different interest business groups and legislators in the Congress to this proposal. The business associations argued that the dividend withholding tax would unfairly 'constitute double taxation, first on corporations and again

98. In general, developing countries are depending on withholding taxes on royalties, interest, and technical services whereas in the international tax policy of developed countries these withholding tax rates are low or zero. In some developed countries (*e.g.* the Netherlands) withholding taxes on royalties, interest, and technical services even do not exist. If there are developing countries with no tax treaty network, and the BEPS proposals were to be universally adopted, 'companies in such countries would most likely fall back on domestic law of the source countries'. In developing countries, withholding tax can be relatively high and without any treaty applicable, international groups may leave to other countries with treaty network that can provide a reduced withholding tax rate or no withholding tax rate. Therefore, Wagenaar argues that developing countries should have a treaty network. Wagenaar (2015), above n. 40, at Section 3.5.

99. *Ibid.*, at Section 4.

100. Discussion Paper available at the website of the African Tax Research Network; *see* <atrnafrica.org/atrn/documents/download/8>.

101. According to the OECD these three main pillars are: (1) the direct participation of developing countries and of Regional Tax Organisations in the Committee on Fiscal Affairs of the OECD and all technical working groups; (2) the set-up of Regional Networks of tax policy and administration officials on BEPS in five regions to ensure the participation of countries that are not able to regularly attend the Paris-based meetings; (3) capacity building support, including the development of toolkits, to assist countries implement solutions to tackle BEPS; *see* <www.oecd.org/ctp/beps-frequentlyaskedquestions.htm> (last visited 22 March 2017).

102. *See* W.A. Mgimwa, 'Speech by the Minister for Finance Introducing to the National Assembly the Estimates of Government Revenue and Expenditure for the Fiscal year 2012/2013', at 60; *see* <www.mof.go.tz/mofdocs/msemaji/Budget%20english%202013.pdf> (last visited 22 March 2017).

on shareholders'.[103] The tax reform submitted to the Colombian Congress in October 2016[104] contains a proposal for a dividend withholding tax.[105] Due to the previous antecedents in the Colombian Congress regarding the fairness for companies of this tax, it is not yet clear whether this dividend withholding tax will be approved by the Congress.

3.2.2 Equal Treatment/Non-Discrimination

Courts of developed and developing countries may have different views on the interpretation of Article 26 International Covenant on Civil and Political Rights as well as on the non-discrimination provisions in tax treaties. For example, the Dutch Supreme Court in its application of this article tests whether:

- the legislation causes unequal treatment;
- there is no objective and reasonable justification for the unequal treatment.

Moreover, the Dutch Supreme Court applies a quantitative threshold.[106] Generally, in these non-discrimination cases this Supreme Court not only interprets Article 26 ICCPR, but also Article 14 jo. Article 1 Protocol European Convention on Human Rights. Generally, the Dutch Supreme Court rules that budgetary problems are no justification for the unequal treatment. However, in its decision of 29 January 2016, V-N 2016/7.17,[107] the Supreme Court ruled that taking into account the acute revenue problems resulting from the economic crisis and the incidental character of the rule in question (a crisis levy on 'high wage employees') and the specific circumstances of the taxpayer did not fail to strike a fair balance between the interest of the taxpayer in question and the state.

We are not aware of any systematic research on this issue.[108] Nor are we aware of systematic comparative research on the question whether Supreme Courts of developed and developing countries interpret the rules of tax treaty non-discrimination provisions in the same way.

3.2.3 Certainty

Another principle on which developing countries may have other views than developed countries is legal certainty in terms of stability, promulgation, non-retroactivity and clarity of laws. Simple legislation for example is more important, amongst others, due to lack of (sufficiently trained and sufficiently paid) tax administrators and judges and the lack of administrative guidance, rulings, concepts, etc. Examples of rules that are difficult to apply for taxpayers, tax administrators and tax judges in developing countries are the application of transfer pricing provisions, the application of tax provisions such as beneficial ownership to prevent tax treaty abuse, and the exchange of information among tax administrations. The BEPS Project and BEPS Action Plan 'brings more challenges including the development of international standards to address the digital economy, hybrid mismatches, redefinition of the concept of permanent establishment, and introduction of complex tax treaty abuse provision such as limitation on benefits among others'.[109] World Bank president Jim Yong Kim's call for developing countries to strive for more reasonable and predictable tax levels[110] also shows developing countries do not yet have the same perception as developed countries on the relevance of providing legal certainty to taxpayers.

3.3 Intermediate Conclusion

Section 3 addressed the question of whether the perception of fairness between developing countries and developed countries is the same or different. The description in Section 3.1 has shown that both the economic and juridical perceptions of fairness differ between these countries. Section 3.1 shows that the differences in perception of economic fairness arise due to the fact that developing countries have a higher dependence on CIT as source of revenue and on tax incentives as method to attract investment. In addition, developing countries and developed countries have different views (i) on level

103. G.A. Flores-Macias, 'Chapter 3 The Political Economy of Colombia's 2012 and 2014 Fiscal Reforms', in J.E. Mahon Jr, M. Bergman & C. Arnson (eds.), *Progressive Tax Reform and Equality in Latin America*, Wilson Center, at 101-27. Specific reference to the role of business associations is made at 108-110; *see* <www.arts.cornell.edu/gaf44/pdfs/FloresMacias%20_%20Political%20Economy%20of%20Colombia%202012%20and%202014%20fiscal%20reforms%20(single%20chapter).pdf>.
104. Reuters, 'Colombia Tax Reform to Go to Congress in October: President'; *see* <www.reuters.com/article/uscolombia-economy-taxation-idUSKCN10N2MG?il=0> (last visited 22 March 2017).
105. A proposal has been presented in the final report issued in February 2016 by the Tax Experts Commission (the Commission) *ad honorem* appointed by the government to analyse and propose amendments on tax matters. The final report provides recommendations for the implementation of a structural tax reform. One recommendation is to introduce 'income tax on dividends paid to either residents or non-residents subject to a 20% tax deduction if the dividends are paid out of profits that were taxed at the level of the company; therefore, if the applicable income tax rate for a taxpayer is 35%, the effective income tax rate applicable to dividends would be 15%; if the applicable income tax rate is 20% or less, the dividend will not be taxed' 'Colombia – Tax Experts Commission's final report' (2016).
106. *See, e.g.* Supreme Court 15 July 1998, No. 31.922, BNB 1998/293, VN 1998/36.4.
107. *See, e.g.* Supreme Court 29 January 2016, No. 15/00340, V-N 2016/7.17.
108. The Jurisprudence Database of the United Nations Human Rights Office of the High Commissioner; *see* <http://juris.ohchr.org/> (last visited 22 March 2017), gives an overview of cases amongst others on Art. 26 ICCPR.
109. *See* Valderrama (2015), above n. 7, 615, at 623.
110. Remarks by World Bank President Jim Yong Kim at the Global Connect Initiative, World Bank–IMF Spring Meetings 2016 in the context of bridging the 'digital divide': more than four billion people without internet access and 90% of them living in developing countries, 'If we are to bring these sorts of benefits to all countries – and to achieve SDG targets – we have to increase our efforts exponentially. Ministers of Finance can contribute in three ways: First, fair telecom taxation. Governments in many developing countries have taxed the ICT sector at rates significantly higher than other services. Governments need to ensure more reasonable and predictable tax levels'; *see* <www.worldbank.org/en/news/speech/2016/04/14/remarks-by-world-bank-group-president-jim-yong-kim-at-the-global-connect-initiative>.

playing for the digital and the traditional economy; (ii) on allocation of taxing rights and (iii) on fair tax systems and fair and efficient tax administrations. These differences are not only due to the BEPS Projects but also due to the economic development of a country.

Section 3.2 shows that there are also differences in the juridical perspective to fairness mainly regarding equality and certainty. Developed and developing countries have different views regarding equal treatment to group of companies. They may also have different views on the interpretation of non-discrimination provisions in International Human Right Conventions and tax treaties; and on the importance of the principle of certainty in drafting tax law and instruments to provide legal certainty to taxpayers such as rulings.

How to overcome these differences? The following section will provide our recommendations to address the differences in perception.

4 Recommendations

This section aims to answer the question what, if anything, can be done to achieve fairness for both developed and developing countries? Below we give some – by no means exhaustive – recommendations.

4.1 Tax Principles, Code of Conduct of Taxation and Broadening of the BEPS-Agenda

In 1998 the OECD formulated the Ottawa principles of taxation, which to a high extent reflect Adam Smith Canons[111] and thus an economic perspective: neutrality, efficiency, certainty and simplicity, flexibility and effectiveness and fairness. The OECD explains the principle of fairness as: 'The potential for tax avoidance and evasion should be minimalised while keeping counter-acting measures proportionate to the risks involved.'[112] These principles reflect an economic approach to fairness.

For this, Richard Murphy's *Code of Conduct of Taxation* would be a good starting point as the fairness principles are reflected in this Code. The Code was developed to favour the interpretation of law according to its purpose and the intention for which it was implemented. This Code has fourteen principles of taxation based on the Universal Declaration of Human Rights. These principles include, among others, the duty of the state to protect its citizens, to provide public goods for its citizens, to refrain from discrimination, etc.[113]

We recommend the OECD, IMF, UN and WB (four IOs) to develop a set of tax principles jointly. One of the issues that should be addressed in the discussion is the perspective of the different countries on whether the social contract theory underlies taxation and if so how the concept of 'fair share' to be paid by the taxpayers could be made operable in such a way that it offers both taxpayer and the state sufficient certainty on the amount of tax to be paid. Academic research may offer some guidance in this.

We also recommend the four IOs to collectively work on the follow-up of the OECD's Report on the impact of BEPS in Low Income Countries (2014) and the IMF Policy Paper Spillovers in International Corporate Taxation (2014) and to broaden the scope of the BEPS project. Comparative research by academic researchers may elevate the discussion to a higher level.

In light of the BEPS Agenda, further research should also be carried out on the practical implementation of BEPS in developing countries. It is not yet clear what is the motivation for countries outside the BEPS 44 Group to participate as BEPS Associate and to implement BEPS. It is also not clear how countries will implement BEPS including the role of the Legislative, Executive and Judiciary in the implementation of BEPS, and whether the implementation of the BEPS Actions will be compatible with the rules of countries to attract investment. Nor is it clear how this implementation will influence the decision to invest by multinationals operating worldwide.

4.2 Participation of the UN and Joint Work of the Four IOs

As rightly stated by Dagan, BEPS has centred on achieving tax revenue rather than on considerations of justice (Section 2.5). The initiative of the World Bank and IMF of July 2015 to deepen the dialogue with developing countries on international tax issues and to develop tools to help member countries to evaluate and strengthen their tax policies, as well as OECD's clear intention to involve developing countries in the implementation of the BEPS project is a good step towards achieving cooperation between states. However, the authors recommend that this initiative should also include the UN that has experience in the design of international tax proposals for developing countries.

At this stage, the role of the UN is limited mainly due to the rejection by developed countries in the July 2015 Financing for Development Conference of the proposal to give to the UN Tax Committee the status of intergovernmental body. The involvement of the UN is necessary to ensure that the initiative of the IMF and World Bank goes beyond technical assistance, that it gives a voice to developing countries and that it will result in concrete proposals for cooperation between developing and developed countries. Notwithstanding the acknowledgment by developed countries of the leading role played by the OECD and the lack of resources of the UN, we recommend the UN to have a larger role in the discussion of BEPS with some additional financ-

111. Smith (1904), above n. 90.

112. OECD, 'Implementation of the Ottawa Framework Conditions The 2003 Report' (2003); *see* <www.oecd.org/tax/administration/20499630.pdf> (last visited 22 March 2017); Referred to also in the 5 October 2015 Report OECD, 'BEPS Action 1 Addressing the Challenges of the Digital Economy' (2015); *see* <www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-action-1-2015-final-report-9789264241046-en.htm>, Annex A and Annex C.

113. R. Murphy, 'A Code of Conduct for Taxation' (2007); *see* <www.taxresearch.org.uk/Documents/TaxCodeofConductFinal.pdf> (last visited 22 March 2017).

ing by the World Bank since this institution has also addressed the importance of giving a voice to developing countries in the setting of international tax standards (Section 2.4.2).

4.3 Revenue Sharing

In the words of Rawls, a proper distribution of benefits and burdens of social cooperation includes a fair division of taxation rights between states.[114] The philosophical approach to fairness aims for citizens to contribute to society and for multinationals to refrain from using aggressive tax planning since it will not be fair vis-à-vis local business and it will reduce compliance from local business. Mechanisms of sharing of extra revenue that will be the result of BEPS measures between developing and developed countries should be included in the agenda of the four IOs. In order to address this issue, statistical information on the benefits and costs of BEPS should be collected either by the four IOs or by academic researchers. This still open issue will affect how developing countries perceive the legitimacy of the BEPS proposals.

The approach to revenue sharing has been made in the past by one of the authors in respect of exchange of information stating that 'exchange of information may result in more revenue for countries that have the technological and administrative resources to deal with the information exchanged. Developing countries will need an additional motivation to exchange information, and this could be for instance revenue sharing between developed and developing countries.'[115]

An empirical study carried out by Paolini *et al.* states that 'revenue sharing compensates the developing economy for the loss of tax base, the cost of implementing tax auditing and (in case of firm relocation) also for the financial subsidy paid to firms to stay'.[116] Therefore, this study concludes that it is possible for developing countries to voluntarily sign a tax treaty that includes exchange of information, tax audit and revenue sharing.[117] Furthermore, in the field of administrative assistance, as rightly argued by Turina, it is relevant to design an incentive-based approach (*i.e.* revenue sharing) as a policy tool to ensure ex ante compliance with administrative assistance agreements.[118]

4.4 Systematic Research on the Ideas of Fairness, Equality and Certainty

As mentioned in Section 3.2, developing countries may have other ideas of equality and certainty than developing countries. IMF argues rightly that research is needed on the issue whether all BEPS recommendations are equally relevant to developing countries. Such research is indispensable for the political perspective of fairness and creating legitimacy. Researchers, governments and international organisation should pay more attention to what is meant with fairness in general and to differences in perception between countries more specific in their discussions on how to prevent tax avoidance and tax evasion.

For purposes of the design of a global tax system that is fair and provides both equality and certainty, research and also a political discussion are indispensable on the question of what is 'real economic benefit' (Fair Tax Mark[119]) or 'the jurisdiction where the true economic activity occurs' (Tax Justice[120]) or 'the economic activity undertaken in that country' (UN[121]) or 'the jurisdiction where profits are generated' (EU[122]) or 'where value is created' (OECD BEPS Action 10[123]).

4.5 Participation on Equal Footing of Developing Countries

These authors furthermore recommend that by using the fairness approach, developed countries should ensure that the needs of developing countries are also

114. Rawls, justice provides 'a way of assigning rights and duties in the basic institutions of society and they define the appropriate distribution of the benefits and burdens of social cooperation'. A Theory of Justice, Oxford University Press, Oxford, (1971), at 2; *See also* J. Rawls, 'Justice as Fairness', 67 *The Philosophical Review* 2, at 178 (1958); J. Rawls, 'Justice as Fairness: Political Not Metaphysical', 14 *Philosophy & Public Affairs* 3, at 223-51 (1985).
115. *See* Valderrama (2015), above n. 22, 381, at 358.
116. D. Paolini, P. Pistone, G. Pulina & M. Zagler, 'Tax Treaties with Developing Countries and the Allocation of Taxing Rights', 38 *European Journal of Law and Economics* 2 (2014).
117. *Ibid*.
118. A. Turina, 'Information-Based Administrative Tax-Cooperation, Consolidating Standards, Emerging Actors and Evolutionary Perspectives' (Doctoral Thesis defended at Bocconi University Milan 2013).
119. Recently the founder of the non-governmental organisation 'Tax Justice Network' Richard Murphy took the initiative for a FairTaxMark for UK companies. According to the FairTaxMark website, 'fair tax' means that a business seeks to pay the right amount of tax (but no more) in the right place at the right time; *see* <www.fairtaxmark.net/> (last visited 22 March 2017).
120. Tax Justice Network stated in 2014: 'in a highly globalised world dominated by large multinational corporations, it is essential to ensure that taxes are paid where the true economic activity occurs. Under current global rules, this is often not the case, and companies are able to shift profits around the globe to places where they will be taxed less. This has a particularly devastating impact on developing countries'. *See* 17 October 2014; <www.taxjustice.net/2014/10/17/fair-taxes-key-fair-share/> (last visited 22 March 2017).
121. The UN, when explaining BEOS Action 13, stated that the information provided in the transfer pricing documentation (profits earned and tax paid, assets owned and number of employees) may be useful for 'tax authorities trying to identify whether an MNE is leaving an amount of income in a jurisdiction that fairly reflects the economic activity undertaken in that country', at 16; *see* <www.un.org/esa/ffd/tax/BEPS_note.pdf> (last visited 22 March 2017).
122. For the EU Commission, companies should pay taxes where profits are generated and this principle has been undermined by aggressive tax planning. For the Commission, 'The majority of businesses do not engage in aggressive tax planning and suffer a competitive disadvantage to those that do. The aggressive behaviour of these companies distorts price signals and allows them to enjoy lower capital costs, disrupting the level playing field in the Single Market. Small and medium sized businesses are particularly affected by this phenomenon'. Communication from the Commission to the European Parliament and the Council. 'Anti-Tax Avoidance Package: Next Steps towards Delivering Effective Taxation and Greater Transparency in the EU', COM(2016) 23 final, at 2 (28 January 2016); *see* <http://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:52016DC0023&from=EN> (last visited 22 March 2017).
123. OECD, 'Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 Final Reports' (2015); *see* <http://dx.doi.org/10.1787/9789264241244-en> (last visited 22 March 2017).

taken into account. IOs including the UN should develop mechanisms to make sure that participation in the inclusive framework of BEPS Associates is truly on equal footing and that the outcome of the negotiations of the BEPS multilateral instrument is transparent by providing information on what was adopted, and whether the needs/voice of developing countries were also taken into account in the final outcome, that is the BEPS multilateral instrument. Therefore, the authors feel that the outcome of these meetings – including the agenda, and the proposals of developed countries, developing countries and IOs – should be made available on the website of the OECD. In order for this framework to be truly inclusive, the agenda should also be inclusive. Therefore, the discussion should be not only on BEPS issues, but also on non-BEPS issues that have been identified as relevant for developing countries. These issues have been identified in Section 2.1 and are, among others, tax incentives, tax treaty cost/benefit analysis, introduction of transfer pricing rules, and the limited administrative capacity of the tax administration.

Furthermore, the inclusiveness should also result in more participation of the taxpayer including business association, tax advisers' associations, and taxpayers' associations.[124] Till now the participation has been limited to voluntary participation by these associations in consultations and in some cases position papers regarding the BEPS Actions.[125] Finally, we believe that BRICS can function as a bridge to reduce the different perspectives of developed and developing countries on tax fairness.[126]

5 Final Remarks

Ostwal raised the question 'who will adopt the OECD's plan against BEPS, after all?'[127] In order to get these plans adopted, it is essential that global fairness will be achieved for both developing and developed countries. International organisations play an essential role in achieving fairness, even if they do not have the same powers as legislators. We recall Nagel's quotes on this presented in Section 2.5: 'global justice requires global sovereignty' and 'the most likely path toward some version of global justice is through the creation of potentially unjust and illegitimate global structures of power that are tolerable to the interests of the most powerful current nation-states'.

124. An interesting example of this broader participation is the November 2016 Regional Meeting of the Inclusive Framework of BEPS for African French-speaking countries. The event was hosted by the Ministry of Economy and Finance of Tunisia, and organised by the OECD in partnership with CREDAF (*Centre de rencontres et d'études des dirigeants des administrations fiscales*). The World Bank Group was also represented. Participants included senior officials from Ministries of Finance and Tax Administrations from Algeria, Benin, Burkina Faso, Cote d'Ivoire, Democratic Republic of the Congo, France, Gabon, Guinea, Madagascar, Mauritania, Morocco, Senegal and Tunisia, as well as business representatives (PricewaterhouseCoopers, Cabinet Bile-Aka, Brizoua-Bi et Associés) and members from civil society such as the BEPS Monitoring Group and TUAC; *see* <www.oecd.org/fr/fiscalite/beps/resume-co-presidents-reunion-regionale-du-cadre-inclusif-beps-tunis-2016.pdf>.
125. One of the most active participants regarding BEPS has been the Business and Industry Advisory Committee; *see* <http://biac.org/focus-areas/international-taxation/> (last visited 22 March 2017).
126. The impact of the BRICS on the international tax regime has been thoroughly analysed in Y. Brauner and P. Pistone (eds.), 'BRICS and the Emergence of International Tax Coordination', *IBFD* (2015).
127. Ostwal, above n. 35.

The Reasonableness Test of the Principal Purpose Test Rule in OECD BEPS Action 6 (Tax Treaty Abuse) versus the EU Principle of Legal Certainty and the EU Abuse of Law Case Law

Dennis Weber*

Abstract

The OECD BEPS Action 6 report contains a principal purpose test rule (PPT rule) for the purpose of combating abuse of tax treaties. This PPT rule is also included in the OECD Multilateral Instrument.

The PPT rule is (amongst others) applicable when 'it is reasonable to conclude' that a benefit (granted by a tax treaty) was one of the principal purposes of any arrangement/transaction. This requirement contains two elements: the reasonableness test and the principal purpose test.

In literature it is observed that (i) the reasonableness test of the PPT rule could be contrary to the European Union's principle of legal certainty; (ii) that the OECD PPT rule gives the tax authorities too much discretion and, therefore, is not in line with EU law and (iii) there is doubt whether the OECD PPT rule contains a genuine economic activity test and therefore is in contravention of the abuse of law case law of the CJEU.

In this contribution, I defend that none of the above-mentioned reasons the OECD PPT rule is contrary to EU law. The only potential problem I see is that the OECD PPT rule is broader (no artificiality required) compared to the GAARs in Anti-Tax Avoidance Directive and the Parent–Subsidiary Directive.

Keywords: GAAR, abuse, tax avoidance, BEPS, principal purpose test, legal certainty

1 Introduction

The OECD BEPS Action 6 report contains a principal purpose test rule (PPT rule)[1] for the purpose of combating abuse of tax treaties. This PPT rule is also included in the Multilateral Convention to implement tax treaty related measures to prevent base erosion and profit shifting (often called MLI, the 'Multilateral Instrument').

The PPT rule is (amongst others) applicable when 'it is reasonable to conclude' that a benefit (granted by a tax treaty) was one of the principal purposes of any arrangement/transaction. This requirement contains two elements: the reasonableness test and the principal purpose test.

It is observed first in literature that the reasonableness test of the PPT rule could be contrary to the European Union's principle of legal certainty.[2] Reference is made in this regard to the judgments of the Court of Justice of the European Union (CJEU) in *SIAT*[3] and *Itelcar*.[4] Second, it is defended in literature that the OECD PPT rule gives the tax authorities too much discretion and, therefore, is not in line with EU law (based on the *Biehl* case). Third, there is doubt whether the OECD PPT rule contains a genuine economic activity test and therefore is in contravention of the abuse of law case law of the CJEU.[5]

If the reasonableness test of the PPT rule is not in line with the EU principle of legal certainty or any other EU principle, this would mean that the EU Member States are not permitted to incorporate the PPT rule via the MLI or in another way in their bilateral tax treaties.

* Dennis Weber is a professor of European corporate tax law at the University of Amsterdam and director and founder of the Amsterdam Centre for Tax Law (ACTL).

1. *See* BEPS Action 6: Preventing the granting of treaty benefits inappropriate circumstances, OECD, 5 October 2015.
2. *See* E.C.C.M. Kemmeren, 'Where is EU Law in the OECD BEPS Discussion?' (editorial), 23(4) *EC Tax Review* 190 (2014) followed by: Kokolia and Chatziioakeimidou, 'BEPS Impact on EU Law: Hybrid Payments and Abusive Behaviour', ET, April 2015, at 155 and E. Pinetz, 'Final Report of Action 6 of the OECD/G20 Base Erosion and Profit Shifting Initiative: Prevention of Treaty Abuse', *IBFD Bulletin* 113 (2016).
3. CJEU 5 July 2012, Case C-318/10 (*SIAT* v *État belge*), ECLI:EU:C:2012:415.
4. CJEU 3 October 2013, *Itelcar*, C-282/12.
5. Fourth, in the literature the question is asked whether the fact that under the PPT rule there must be 'one of the *principal* purposes', whereas in the abuse case law of the CJEU it must concern a '*wholly* artificial arrangement', is in contravention of EU law. I shall not discuss this in this contribution. *See* on this: D. Weber, 'The New Common Minimum Anti-abuse Rule in the EU Parent-Subsidiary Directive: Background, Impact, Applicability and Effect', 44(2) *Intertax* 98 (2016), paras. 6.1 and 6.2.

In this contribution, I therefore discuss the question of whether the reasonableness test of the PPT rule is contrary to the EU principle of legal certainty. For this, I discuss the case law of the CJEU in this area and subject the cases *SIAT* and *Itelcar*, which are cited in the literature in order to defend that the PPT rule is contrary to the principle of legal certainty, to further examination, together with a number of other judgments of the CJEU.

2 The Principal Purpose Test (PPT)

2.1 Introduction: The PPT Rule

The PPT rule as is included in the MLI (the content of which is the same as the PPT rule which is incorporated in the OECD BEPS Action 6 report) reads as follows:

> ***Article 7 – Prevention of Treaty Abuse***
> 1. Notwithstanding any provisions of a Covered Tax Agreement, a benefit under the Covered Tax Agreement shall not be granted in respect of an item of income or capital if it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction that resulted directly or indirectly in that benefit, unless it is established that granting that benefit in these circumstances would be in accordance with the object and purpose of the relevant provisions of the Covered Tax Agreement.

2.2 The Reasonableness Test

2.2.1 An Objective Analysis of All Relevant Facts and Circumstances

The PPT rule is applicable when 'it is reasonable to conclude, having regard to all relevant facts and circumstances, that obtaining that benefit was one of the principal purposes of any arrangement or transaction'. This requirement contains two elements: the reasonableness test and the principal purpose test. Although those two tests are distinct elements of the PPT rule, they are inextricably linked and, in my view, must be applied jointly.

The wording 'it is reasonable to conclude, having regard to all relevant facts and circumstances' is the so-called 'reasonableness test'. For the application of the reasonableness test in the PPT rule, points 10 and 11 of the Commentary on the PPT rule in the final report on Action 6 are of importance. These read as follows:[6]

> 10. To determine whether or not one of the principal purposes of any person concerned with an arrangement or transaction is to obtain benefits under the Convention, it is important to undertake an objective analysis of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it. What are the purposes of an arrangement or transaction is a question of fact which can only be answered by considering all circumstances surrounding the arrangement or event on a case by case basis. It is not necessary to find conclusive proof of the intent of a person concerned with an arrangement or transaction, but it must be reasonable to conclude, after an objective analysis of the relevant facts and circumstances, that one of the principal purposes of the arrangement or transaction was to obtain the benefits of the tax convention. It should not be lightly assumed, however, that obtaining a benefit under a tax treaty was one of the principal purposes of an arrangement or transaction and merely reviewing the effects of an arrangement will not usually enable a conclusion to be drawn about its purposes. Where, however, an arrangement can only be reasonably explained by a benefit that arises under a treaty, it may be concluded that one of the principal purposes of that arrangement was to obtain the benefit.
> 11. A person cannot avoid the application of this paragraph by merely asserting that the arrangement or transaction was not undertaken or arranged to obtain the benefits of the Convention. All of the evidence must be weighed to determine whether it is reasonable to conclude that an arrangement or transaction was undertaken or arranged for such purpose. The determination requires reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered.

Reasonableness tests are common to common law systems;[7] for example, they are included in the General Anti-Tax Avoidance Rule (GAAR) of the UK (see also later), Australia, Canada and South Africa.[8] By including a reasonableness test in a GAAR, the subjective intention that obtaining a tax benefit was the (main/principal, etc.) purpose for a transaction, is objectified:[9] to know the subjective intention of a taxpayer or arrangement, an objective analysis must be made of the (objective) facts and circumstances.

The subjective test in the PPT rule (the principal *purpose*) is objectified by the reasonableness test:[10] 'it is *reasonable* to conclude [means: objective analysis], *having regard to all relevant facts and circumstances*' [means: objective facts and circumstances]. (emphasis added)

6. *See* BEPS Action 6, above n. 1, paras. 10 and 11 of the Commentary on the PPT rule.

7. Reasonableness tests are also used outside of tax law, for example, 'a reasonable doubt' in UK, US and Canadian criminal law.

8. *See* P. Rosenblatt, *General Anti-Avoidance Rules for Major Developing Countries*, Kluwer Law International (2014), para. 3.2.1.

9. *See* R. Krever, 'General Report: GAARs', published in GAARS – A Key Element of Tax Systems in the Post-BEPS, European and International Tax Law and Policy Series, No. 3, IBFD (2016), in para. 1.4. 'taxpayer's purpose'.

10. *See also* Reinout Kok, 'The Principal Purpose Test in Tax Treaties Under BEPS 6', 44(5) *Intertax* (2016), at 406.

That the reasonableness test is an objective test is clearly worded in the Commentary to the PPT:[11]

> to determine whether or not one of the principal purposes of any person concerned with an arrangement or transaction is to obtain benefits under the Convention, it is important to undertake an *objective analysis* of the aims and objects of all persons involved in putting that arrangement or transaction in place or being a party to it. What are the purposes of an arrangement or transaction, is a *question of fact*, which can only be answered by considering *all circumstances* surrounding the arrangement or event on a case-by-case basis. It is not necessary to find conclusive proof on intent of a person concerned with an arrangement or transaction, but it must be reasonable to conclude *after an objective analysis* of the relevant facts and circumstances, that one of the principal purposes of the arrangement or transaction was to obtain the benefits of the tax convention. (emphasis added)

It is also remarked in point 11 of the Commentary that all relevant facts and circumstances (the evidence) 'must be *weighed* to determine whether it is reasonable to conclude that an arrangement or transaction was undertaken or arranged for such purpose'. In my view, substance can only be given to the wording, can 'be weighed', when the tax authorities substantiate with reasons in the assessment how the various facts and circumstances relate to each other.

Furthermore, in point 11 of the Commentary, it is observed that 'The determination requires reasonableness, suggesting that the possibility of different interpretations of the events must be objectively considered'. In my view, this should be interpreted such that in the interpretation of the 'facts and circumstances' these must be interpreted such as a reasonable (third) person would have interpreted those facts and circumstances. The *analysis* of the facts and circumstances is therefore also objective.

The assessment of the tax authorities that obtaining a tax benefit was one of the principal purposes of a transaction must thus be based on:

- all relevant facts and circumstances
- which must be weighed
- in an objective analysis

It can be gathered from this that this assessment is not an easy test. That is also emphasised in the Commentary. In point 10, it is remarked: 'It should *not be lightly assumed*' (emphasis added) and in that regard, it is pointed out that '*merely* reviewing the *effects* of an arrangement will not usually enable a conclusion to be drawn about its purposes' (emphasis added). It is shown from this that the tax authorities may not *assume* that a tax benefit is the principal purpose of an arrangement to obtain a treaty benefit, but also that they may not only point out the *effects* in their assessment so to come to the conclusion that the principal purpose of an arrangement is to obtain a treaty benefit. The tax authorities may thus, for example, not point out a large tax benefit and from that, draw the conclusion that obtaining that benefit was one of the principal purposes of an arrangement or transaction. On the other hand, the taxpayer may not merely assert this. In point 11 of the Commentary it is observed in this regard: 'A person cannot avoid the application of this paragraph by merely asserting that the arrangement or transaction was not undertaken or arranged to obtain the benefits of the Convention.'

In the Commentary on the OECD PPT rule, several examples are given. As an example that the OECD PPT rule is not applicable, a reference is made to the situation that a certain shareholding in a company is 'related to the expansion' of the shareholders 'business and lower manufacturing costs'.[12] In another example, the OECD PPT rule is not applicable because there is the establishment of a regional group services company that has a 'real business', whereby the service company 'exercises substantive economic functions, using real assets and assuming real risk' and that the business is carried on by the company 'through its own personnel'.[13] In the OECD Action 6-report is also a reference to 'valid commercial reasons'.[14] It appears from the examples given in the Commentary that many different facts and circumstances must be weighed against each other in order to reach the conclusion on whether there is or is not treaty abuse. It also appears from this that the PPT rule requires an in-depth study of the facts and circumstances, and that nothing may be based on assumptions.

2.2.2 Comparable Reasonableness Test in UK GAAR

As mentioned above, the reasonableness test is often included in GAARs in common law systems. In 2013, a GAAR was introduced in the UK, and although there is nothing to show that the OECD PPT rule is based on the UK GAAR, their reasonableness tests are similar. The reasonableness test in the UK GAAR reads:[15] 'Arrangements are "tax arrangements" if, *having regard to all the circumstances*, it would *be reasonable to conclude* that the obtaining of a tax advantage was the main purpose, or one of the main purposes, of the arrangements' (emphasis added). The following observation is made on this in the HMRC GAAR Guidance:[16]

11. *See* BEPS Action 6, above n. 1, para. 10 of the Commentary on the PPT rule.
12. Preventing the granting of treaty benefits in inappropriate circumstances, Action 6: final report, OECD/G20 Base Erosion and Profit Shifting project, 5 October 2015, Commentary on the PPT rule: point 14, example C (manufacturing plant in developing country).
13. Preventing the granting of treaty benefits in inappropriate circumstances, Action 6: final report, OECD/G20 Base Erosion and Profit Shifting project, 5 October 2015, Commentary on the PPT rule: point 14, example G.
14. Preventing the granting of treaty benefits in inappropriate circumstances, Action 6: final report, OECD/G20 Base Erosion and Profit Shifting project, 5 October 2015, Commentary on the PPT rule: point 8.
15. Art. 207(1) Finance Act 2013.
16. HM Revenue and Customs (HMRC) General Anti Abuse Rule (GAAR) guidance (Approved by the Advisory Panel with effect from 30 January 2015), c.3.3.

> The expression 'reasonable to conclude' shows that this is an *objective test*, which is to be applied by taking into account all the relevant circumstances and asking whether, in the light of those circumstances, a *reasonable conclusion* would be that obtaining a tax advantage was the main purpose, or one of the main purposes, of the arrangements. It is neither necessary nor appropriate to enquire whether any particular person (for example the taxpayer himself, or a promoter of the arrangements, if there was one) actually had that intention. In practice, though, it would be very rare to find a situation where objectively the obtaining of a tax advantage appeared to be one of the main purposes of an arrangement although, subjectively, the participators did not in fact have any such aim. (emphasis added)

Also here we see clearly that the reasonableness test is an objective test in which the subjective intention of the taxpayer is derived from objective circumstances and that it must concern a 'reasonable conclusion'.

2.2.3 *Different Interpretation in Literature*

In literature, a different interpretation of the reasonableness test is also defended. Lang writes:[17] 'On the other hand, the requirements are not too demanding – it must be merely "reasonable": but not, for instance, compelling. Therefore, the tax authority does not need to produce full evidence thereof". Bhargava also observes that "the tax authorities will find it easier to prove" "as the threshold that is set out is very low ("reasonable to conclude")'.[18] And Pinetz:[19] 'the requirements are (…) quite lenient, as it need only be reasonable to conclude'.

I do not agree with this interpretation. In my view, the wording 'reasonable to conclude' does not mean the *weight* of the burden of proof on the tax authorities, but it means that the assessment of the tax authority must be obtained through an objective analysis based on facts and circumstances (and it has to weigh all facts and circumstances; may thus not be based on an assumption; or only refer to the tax advantage as such).

Lang writes:[20] 'In practice, furnishing evidence of the motives will therefore not be relevant, but the tax authorities will be tempted to *presume* intention simply because of the presence of a benefit' (emphasis added). Pinetz also notes that 'the wording of the provision proposed by the OECD makes it easy for tax authorities to *assume* abuse' (emphasis added). In my view, that is not what the PPT rule prescribes. The reasonableness test in the OECD PPT rule prescribes an objective analysis of all relevant facts and circumstances, such as this is, often to be found in GAARs in common law systems, and from the OECD Commentary it is clearly observed (see also here above) that an assessment that is based on an assumption or is only based on the effect of an arrangement (the tax benefit) is not sufficient.

In literature, moreover, it is noted that the subjective test in the PPT rule cannot be rebutted by proving that valid commercial reasons exist for the transaction.[21] In my view this is incorrect. The PPT rule requires that the tax authorities determine, by means of the reasonableness test, the principal purpose of the transaction. When the tax authorities come to the conclusion on the basis of the facts and circumstances at their disposal that the principal purpose of an arrangement is to obtain a tax benefit, then the taxpayer can always dispute this in an objection against his tax assessment or before a court. In that regard, the taxpayer can thus put forward the relevant facts and circumstances. In addition, in practice, before they apply the PPT rule, in most situations the tax authorities will request the taxpayer by letter to provide relevant facts and circumstances. In such a case, the taxpayer can thus provide his economic reasons (based on facts and circumstances) for an arrangement. When the tax authority *only* applies the PPT rule on the basis of the fact that there is a tax benefit, then the application of the PPT rule must, in my view, be refused by a national court. It is shown from the Commentary, namely, that on the basis of solely the 'effect' of an arrangement, the PPT rule may not be applied.

2.3 EU-Problems in Literature

In literature, it is remarked that the reasonableness test of the PPT rule is contrary to the principle of legal certainty. Kemmeren[22] remarks on this that the reasonableness test 'may create too much uncertainty to taxpayers'. He refers particularly to the *Itelcar* case in which the CJEU ruled on whether national legislation was in line with the requirement of legal certainty. His analysis would seem to be endorsed by Kokolia/Chatziioakeimidou[23] and Pinetz.[24] Baker examines the reasonableness test of the PPT rule also on compatibility with the EU principle of legal certainty.[25] He too mentions in that regard the judgments of the CJEU in *SIAT* and *Itelcar*. He subsequently compares the PPT rule with the comparable anti-abuse rule such as is included in the

17. M. Lang, BEPS Action 6: Introducing an antiabuse rule in tax treaties, Tax Notes International, 655, at 658.
18. A. Bhargava, 'The Principal Purpose Test: Functioning, Elements and Legal Relevance', in Blum and Seiler (eds.), *Preventing Treaty Abuse*, Series on International Tax Law (2016), 311, at 318.
19. Pinetz, above n. 2, at 116. *See also* E. Pinetz, 'Use of the Principal Purpose Test to Prevent Treaty Abuse', in Lang *et al.* (eds.), *Base Erosion and Profit Shifting (BEPS)*, Series on International Tax Law (2016), Linde, at 271.
20. Lang, above n. 17.
21. *See* O. Koriak, 'The Principal Purpose Test Under BEPS Action 6: Is the OECD Proposal Compliant with EU Law?' *ET* (2016), at 552 and C. Panayi, 'The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU Law', 1(2) *IBFD Bulletin* 95 (2016).
22. Kemmeren, above n. 2.
23. Kokolia and Chatziioakeimidou, above n. 2 and Pinetz, above n. 2.
24. Pinetz, above n. 2.
25. P. Baker, The BEPS Action Plan in the light of EU Law: Treaty Abuse, 2015 BTR, no 3, at 408.

Parent–Subsidiary Directive[26] and notes that the PPT rule and this anti-abuse rule are comparable, and that it can be assumed that the anti-abuse rule of the Parent–Subsidiary Directive is in accordance with Union law.[27] On the basis thereof, he comes to the conclusion that, 'it is a reasonable observation that the proposed PPT is not significant less precise or clear than this general anti-avoidance rule inserted into the parent-subsidiary directive'. Baker, therefore, sees no contravention of the principle of legal certainty.

3 The Principle of Legal Certainty in the (Tax) Case Law of the Court of Justice of the EU

3.1 Knowledge of Legal Rules and Foreseeability of Legal Situations

The principle of legal certainty is a fundamental principle of EU law[28] and serves to ensure that legal rules are clear and precise and also that the legal situations and relationships governed by Community law are foreseeable (see *Duff*).[29] Accordingly, the principle safeguards the ability of interested parties to ascertain what their legal rights and obligations are at a certain moment, which in turn ensures that they can be certain as to the legal and economic consequences of their actions.[30] In *Van Es*,[31] it was considered that 'the principle of legal certainty is a fundamental principle of Community law (…) which requires in particular that rules imposing charges on a taxpayer be clear and precise so that he may be able to ascertain unequivocally what his rights and obligations are and take steps accordingly.'[32] In the *Van Es* judgment (a customs case), a Regulation could not be applied to certain tax assessments because the Commission had not adjusted this Regulation and, as a result, a taxpayer was unable to precisely determine his legal position.

26. Art. 1(2) of the Parent–Subsidiary Directive lays down that: 'Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements that, having put into place for the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances'. *See* Council Directive (EU) 2015/121 of 27 January 2015 amending Directive 2011/96/EU on the common system of taxation applicable in the case parent companies and subsidiaries of different Member States {2015} OJ L21/1.
27. *See also* para. 61 of Weber (2016), above n. 5.
28. ECJ 21 September 1983, joined cases 205/82-215/82 (*Deutsche Milchkontor*), ECR 1983, at 2633 (Opinion VerLoren van Themaat).
29. *See* CJEU 15 February 1996, case C-63/93 (*Duff*), ECR I-569 (Opinion Cosmas), para. 20.
30. *Cf.* AG Cosmas in his Opinion to ECJ 15 February 1996, case C-63/93 (*Duff*), ECR I-569, paras. 23 through 25.
31. CJEU 13 February 1996, case C-143/93 (*Van Es*), ECR I-431 (Opinion Elmer).
32. *Id.*, para. 27.

3.2 The Principle of Legal Certainty in Tax Cases

The principle of legal certainty has been the subject of discussion in a number of (tax) cases.

3.2.1 Commission/Greece

In *Commission/Greece*,[33] the question was whether Directive 69/335/EEC concerning indirect taxes on the raising of capital[34] had been implemented correctly into Greek domestic legislation. The discussion in the case concerned the question whether the domestic law that charged capital duty on intra-EU transfers of the effective centre of management or registered office insofar as the company concerned is not subject to capital duty in the Member State of origin, is in line with Directive 69/335/EEC. Of importance in this regard is that the CJEU remarked in paragraph 24:

> While the Hellenic Republic acknowledges that this distinction has not been clearly drawn until now and may have led to a degree of confusion, it nevertheless considers that the criterion of being 'subject to' duty is in accordance with the 'capital company' criterion prescribed by Directive 69/335 and thus correctly transposes Article 4(1)(g) and (h) and (3)(b) of the directive.

In the judgment, the CJEU explained why it was of the opinion that the Greek implementation was contrary to Directive 69/335/EEC. Subsequently, in paragraph 33, it added:

> Furthermore, inasmuch as the Hellenic Republic acknowledges that the distinction between 'actual taxation' and being 'subject to' duty was not clearly made in the transfer rules at issue and may have led to a degree of confusion, it should be added that, in any event, such rules do not satisfy the requirements established by the case-law concerning transposition of directives. According to that case-law, it is particularly important, in order to satisfy the requirement for legal certainty, that individuals should have the benefit of a clear and precise legal situation enabling them to ascertain the full extent of their rights and, where appropriate, to rely on them before the national courts (see to this effect, in particular, Case C-236/95 *Commission* v *Greece* [1996] ECR I-4459, paragraph 13, and Case C-177/04 *Commission* v *France* [2006] ECR I-2461, paragraph 48). The rules cannot be regarded as establishing a clear and precise legal situation of that kind.

It appears from the judgment that Greece 'acknowledges' that the domestic law was not clear and led to 'a degree of confusion'. Greece thus conceded that, in fact, its domestic law was contrary to the principle of legal

33. ECJ 7 June 2007, case C-178/05 (*Commission/Greece*), ECR I-4185.
34. Council Directive 69/335/EEC of 17 July 1969 concerning indirect taxes on the raising of capital (OJ, English Special Edition 1969 (II), at 412), as amended by Council Directive 85/303/EEC of 10 June 1985 (OJ 1985 L 156, at 23) ('Directive 69/335').

certainty. For the CJEU thus, a piece of cake: the CJEU itself did not establish that the domestic legislation was not clear and did not precisely reflect the rights of a taxpayer, but based itself on the statements of the Member State. The arguments on the principle of legal certainty are also used by the CJEU as extra argument to deem the national law not in line with EU law.

3.2.2 SIAT

One direct taxation case in which the CJEU found a national anti-abuse law not in line with the principle of legal certainty is *SIAT*.[35]

This case concerned a Belgian deduction of expenses limitation, which denied a deduction for a payment for performances or services if they were paid to a non-resident company, where the non-resident company was not subject, in the Member State of establishment, to tax on income or was subject, as regards the relevant income, to a tax regime that is appreciably more advantageous than the applicable regime in Belgium. In such a situation, the payments were not deductible unless the taxpayer could prove that such payments related to genuine and proper transactions and did not exceed the normal limits, whereas, under the general domestic rule, such payments were to be regarded as deductible business expenses if they were necessary for acquiring or retaining taxable income and if the taxpayer demonstrated the authenticity and amount of such expenses.

The CJEU considered this rule a restriction on the free movement of services. With regard to the justification grounds, the Court observed (paragraph 48):

> It must therefore be held that legislation such as that at issue in the main proceedings is suitable for attaining the objectives of preventing tax evasion and avoidance and of preserving both the effectiveness of fiscal supervision and the balanced allocation between Member States of the power to impose taxes, all of which – as is apparent from the foregoing – are closely linked in the case before the referring court.

The Court then examined whether or not that legislation goes beyond what is necessary in order to attain those objectives. Under this proportionality test, the Court followed the strict line of reasoning it had established under the anti-abuse case law. Of particular importance is that the Court considered (paragraph 50):

> It is clear from the case law of the Court that, where legislation is predicated on an assessment of objective and verifiable elements for the purposes of determining whether a transaction represents a wholly artificial arrangement entered into solely for tax reasons, it may be regarded as not going beyond what is necessary to prevent abusive practices, if, on each occasion on which the existence of such an arrangement cannot be ruled out, that legislation gives the taxpayer an opportunity, without subjecting him to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that arrangement.

Here, the Court referred to paragraph 82 of the *Test Claimants in the Thin Cap Group Litigation*-case. This was nothing new but was simply a reiteration of old case law. The Court then went on to test whether or not the Belgian rule satisfied the above requirements. The Court considered the following (paragraphs 54-58):

> 54 However, as has been indicated in paragraph 25 above, the special rule may be applied where payments are made to providers who, by virtue of the legislation of the Member State in which they are established, are not subject there to a tax on income or are subject there, for the relevant income, to a tax regime which is appreciably more advantageous than the applicable regime in Belgium.
> 55 Accordingly, as the Advocate General noted in point 71 of his Opinion, the special rule requires the Belgian taxpayer to provide, as a matter of course, proof that all the services are genuine and proper and that all related payments are normal, without the tax authority being required to provide even prima facie evidence of tax evasion or avoidance.
> 56 The special rule can be brought to bear without any objective criterion, verifiable by a third party, being applied to test for the existence of a wholly artificial arrangement which does not reflect economic reality and which has been made with the aim of escaping the tax normally due on the profits generated by activities carried out in the national territory, since account is taken only of the level of tax imposed on the service provider in the Member State in which that provider is established.
> 57 It must be stated that, as has been noted in paragraph 27 above, a rule framed in such terms does not make it possible, at the outset, to determine its scope with sufficient precision and its applicability remains a matter of uncertainty.
> 58 Such a rule does not, therefore, meet the requirements of the principle of legal certainty, in accordance with which rules of law must be clear, precise and predictable as regards their effects, in particular where they may have unfavourable consequences for individuals and undertakings (see, to that effect, Case C-17/03 *VEMW and Others* [2005] ECR I-4983, paragraph 80, and Joined Cases C-72/10 and C-77/10 *Costa and Cifone* [2012] ECR I-0000, paragraph 74). As it is, a rule which does not meet the requirements of the principle of legal certainty cannot be considered to be proportionate to the objectives pursued.

In paragraph 57, the Court referred to paragraph 27 of the decision. The Court stated the following in paragraphs 26-28:

35. *SIAT* (C-318/10), the analysis in this case is partly based on one of my previous analyses on this case, which was published in para. 5.3 of D. Weber, 'Abuse of Law in European Tax Law: An Overview and Some Recent Trends in the Direct and Indirect Tax Case Law of the ECJ', part 2, *IBFD European Taxation* 313 (July 2013).

> 26 As the Belgian Government acknowledges, in the absence of a statutory definition, or administrative instructions as to what is to be understood by 'a tax regime which is appreciably more advantageous than the applicable regime in Belgium', the assessment concerning the applicability of the special rule is carried out on a case-by-case basis by the tax authority, under the supervision of the national courts.
> 27 In those circumstances, the scope of that special rule is not delimited with sufficient precision at the outset and, in a situation where the service provider is established in a Member State other than the Kingdom of Belgium and is subject there to a tax regime which is more advantageous than the applicable regime in Belgium, there is uncertainty as to whether the foreign regime will be considered to be a 'regime which is appreciably more advantageous' and whether, as a result, the special rule will apply.
> 28 Accordingly, that special rule – which lays down stricter conditions for being allowed to deduct business expenses than those laid down in the general rule and the scope of which has not been delimited with precision beforehand – is liable both to dissuade Belgian taxpayers from exercising their right to the freedom to provide services and from making use of the services of providers established in another Member State and to dissuade those providers from offering their services to recipients established in Belgium (see, to that effect, Case C-422/01 *Skandia and Ramstedt* [2003] ECR I-6817, paragraph 28 and the case-law cited).

In *SIAT*, the Court rejected a general anti-abuse rule that reverses the burden of proof in regard to the deduction of expenses (places it on the taxpayer) where the payments to the recipients fall under a 'a tax regime which is appreciably more advantageous than the applicable regime in Belgium' on the basis of the fact that such a measure is too general and is contrary to the principle of legal certainty.

As concerns the opinion that the Belgian law is contrary to the principle of legal certainty,[36] we see that the CJEU, just as in *Commission/Greece*, bases itself on statements of the Member State on the interpretation of the national law. In paragraph 26, the CJEU considers, namely, that

> As the Belgian Government *acknowledges*, in the absence of a statutory definition, or administrative instructions as to what is to be understood by 'a tax regime which is appreciably more advantageous than the applicable regime in Belgium,' the assessment concerning the applicability of the special rule is carried out on a case-by-case basis by the tax authority, under the supervision of the national courts. (emphasis added)

The CJEU, 'in those circumstances', is of the opinion that 'the scope of that special rule is not delimited with sufficient precision at the outset' and 'there is uncertainty as to whether the foreign regime will be considered to be a 'regime which is appreciably more advantageous'and whether, as a result, the special rule will apply' (see paragraph 27). We see thus both in *Commission/Greece* and in *SIAT* that the CJEU follows the qualification of the Member State that a national rule leads to uncertainty because this is not clear ('not clearly') (*Commission/Greece*); or is unclear by the absence of a statutory definition, or because of absence of instructions (*SIAT*) or it leads to 'a degree of confusion' (*Commission/Greece*).

3.2.3 Itelcar

The *Itelcar* judgment[37] concerns Portuguese thin capitalisation legislation. On the basis of this legislation, interest paid between companies between which 'special relations' exist is under certain conditions excluded from deduction from the profit in Portugal. The EU law issue was that interest paid to a lender established in a third country (in the case of Itelcar, the United States) is excluded from deduction, but if the lender was established in Portugal, the interest was always deductible. According to the CJEU, this was a restriction of the free movement of capital between the Member States and third countries. The next question was whether such a restriction may be justified by an overriding reason in the public interest. The Portuguese Government argued that the rules intended

> to combat tax evasion and avoidance by preventing the practice of 'thin capitalisation', which consists of eroding the basis of assessment for corporation tax in Portugal through the payment of interest, which is deductible, instead of profits, which are not deductible. That practice involves the arbitrary transfer of taxable revenues from that Member State to a non-member country, as a result of which the profits of a company are not taxed in the State in which those profits have been generated.

In that connection, the CJEU recalled the settled case-law that

> a national measure restricting the free movement of capital may be justified where it specifically targets wholly artificial arrangements which do not reflect economic reality and the sole purpose of which is to avoid the tax normally payable on the profits generated by activities carried out on the national territory. (paragraph 34)

Subsequently, the CJEU ruled that 'such rules are an appropriate means of attaining the objective of combatting tax evasion and avoidance'. Finally, the CJEU examined whether the Portuguese rules did not go

36. Here, I make no observations on the reasoning of the CJEU that the Belgian rule was too general (that rule was indeed too general, but in my view for other reasons than those given by the CJEU in *SIAT*); *see* further: Weber (2013), above n. 35.

37. CJEU 3 October 2013, *Itelcar*, C-282/12.

beyond what is necessary in order to attain that objective. In that regard, the CJEU reiterated its case law that

> where rules are predicated on an assessment of objective and verifiable elements for the purposes of determining whether a transaction represents a wholly artificial arrangement entered into for tax reasons alone, they may be regarded as not going beyond what is necessary to prevent tax evasion and avoidance, if, on each occasion on which the existence of such an arrangement cannot be ruled out, those rules give the taxpayer an opportunity, without subjecting him to undue administrative constraints, to provide evidence of any commercial justification that there may have been for that transaction. (paragraph 37)

The CJEU found first, that the Portuguese legislation provided for such an opportunity to provide proof (paragraph 39). Subsequently, the CJEU saw another problem. In that regard, the CJEU considered the following:

> 41 As can be seen from paragraph 20 above, the term 'special relations', as defined in Article 58(4) of the CIRC, encompasses situations that do not necessarily involve the lending company of a non-member country holding shares in the resident borrowing company. Where there is no such shareholding, the effect of the method for calculating the excess indebtedness laid down in Article 61(3) of the CIRC is that any credit arrangement between those two companies falls to be regarded as excessive.
> 42 It is clear that, in the circumstances described in the paragraph above, the rules at issue in the main proceedings also affect conduct the economic reality of which cannot be disputed. In presuming that, in such circumstances, the basis of assessment for corporation tax payable by the resident borrowing company is being eroded, those rules go beyond what is necessary to attain their objective.
> 43 Moreover, in so far as the rules at issue in the main proceedings are applied – in accordance with the statements made by the Portuguese Government, as summarised in paragraph 21 above – only to situations in which the lending company has a direct or indirect shareholding in the borrowing company, so that the situation referred to in paragraph 41 above does not arise, the fact remains that such a limitation on the scope of those rules does not follow from their wording, which tends, on the contrary, to suggest that they do cover special relations where there is no such shareholding.
> 44 That being so, the rules in question do not make it possible, at the outset, to determine their scope with sufficient precision. Accordingly, they do not meet the requirements of legal certainty, in accordance with which rules of law must be clear, precise and predictable as regards their effects, especially where they may have unfavourable consequences for individuals and companies. As it is, rules which do not meet the requirements of the principle of legal certainty cannot be considered to be proportionate to the objectives pursued. (see *SIAT*, paragraphs 58 and 59)

It follows from those considerations that the Portuguese provision contains some 'overkill'. The anti-abuse rule is namely also applicable when a loan is provided by a third party (which has no shares in the recipient of the loan); in situations with third parties, the Portuguese thin capitalisation rule leads to the conclusion that each debt between the lender and the borrower must be considered excessive due to which the interest was not deductible. The Portuguese Government contradicted this interpretation of the Portuguese provision and observed that the anti-abuse provision was only applicable to situations in which the lending company has a direct or indirect shareholding in the borrowing company. On this, the CJEU considered that 'such a limitation on the scope of those rules does not follow from their wording, which tends, on the contrary, to suggest that they do cover special relations where there is no such shareholding'; to subsequently consider (paragraph 44):

> That being so, the rules in question do not make it possible, at the outset, to determine their scope with sufficient precision. Accordingly, they do not meet the requirements of legal certainty, in accordance with which rules of law must be clear, precise and predictable as regards their effects, especially where they may have unfavourable consequences for individuals and companies. As it is, rules which do not meet the requirements of the principle of legal certainty cannot be considered to be proportionate to the objectives pursued (see *SIAT*, paragraphs 58 and 59).

In *Itelcar*, we see an anti-abuse provision, which is clearly applicable in the case the lending company is a third party (that will say the lending company had no direct or indirect shareholding in the borrowing company). The Portuguese Government alleged, however, that the rule could only be applied where there was a matter of a direct or indirect shareholding, thus not in the case of a third party. Because this interpretation of the Portuguese rule was in contravention of the clear legislative text, the CJEU observed that the Portuguese rules were not in line with the requirements of legal certainty because the scope of the regulations could not be established with sufficient precision. The similarity of this case with *Commission/Greece* and *SIAT* is that in those cases, the CJEU also based their interpretation of the principle of legal certainty on statements of the relevant Member State. It can be derived from these cases that when the Member State concedes to the CJEU that a certain legislative text gives reason for uncertainty, the CJEU declares the legislation contrary to the principle of legal certainty.

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4 Reasonableness Test in Breach of the EU Principle of Legal Certainty?

The matter which is researched in this article is whether the reasonableness test in the PPT rule is contrary to the EU principle of legal certainty; here I discuss that from various points of view.

4.1 *Commission/Greece*; *SIAT* and *Itelcar*

As has been mentioned above, reference is made in literature especially to *SIAT* and *Itelcar* for the substation that the reasonableness test of the PPT rule is contrary to the principle of legal certainty. In this regard, it is remarked that the PPT rule brings too much uncertainty and that, after citing the grounds from *SIAT* and *Itelcar*, is thus contrary to the principle of legal certainty. No further substantiation is given. In my view, this interpretation takes the rulings in *SIAT* and *Itelcar* about the principle of legal certainty out of their context. When they are read in the context of the case, one must come to the conclusion that those cases cannot be applied to the PPT rule: As I have demonstrated in Section 4 of this article, the CJEU did not independently come to the conclusion in *SIAT* or *Itelcar* or *Commission/Greece*, that the national legislation in those cases was contrary to the principle of legal certainty. The CJEU only came to this conclusion because the Member State *itself* had admitted that the rule was not clear, precise and predictable. Furthermore, in all those cases, contravention with the legal principle of legal certainty was an extra argument to deem the provision contrary to EU law.

4.2 Is Independent Invoking of the Principle of Legal Certainty Possible?

The authors in literature who defend that the reasonableness test is contrary to the principle of legal certainty assume that when the PPT rule is applicable, the principle of legal certainty such as applied in the case law of the CJEU can be invoked. In the cases discussed here in Section 4, we see that in those cases, another contravention of EU law was also at issue: in *Commission/Greece* Directive 69/335/EEC, in *SIAT* and *Itelcar* the EU Treaty freedoms.

The PPT rule does not appear to me to be in contravention of the EU Treaty freedoms. Assume that the PPT rule is applicable, then that would mean that the benefits under the relevant tax treaty would not be granted. This could then mean juridical double taxation arises. Juridical double taxation, however, on the basis of cases such as *Kerckhaert–Morres*,[38] does not constitute a restriction of the EU Treaty freedoms but is a 'result from the exercise in parallel by two Member States of their fiscal sovereignty'.[39]

The question remains whether the principle of legal certainty can be invoked independently, also if the remaining EU law is not applicable. To me, in principle, this would seem impossible. In order to invoke the EU principle of legal certainty, EU law as such must first be applicable.

4.3 Reasonableness Test to be Found in the Case Law of the CJEU Itself: The Objectified Intention/Genuine and Economic Reality-test

4.3.1 Reasonableness Test and Abuse Test in the Case Law of the CJEU: Comparable

The reasonableness test requires that the tax authority must make on the basis of all facts and circumstances an objective analysis that obtaining a benefit is one of the principal purposes of an arrangement. The subjective intention (principal purpose) is hereby derived from this objective analysis. We see a similar test, which can also be called the 'objectified intention test'[40] in the abuse of law case law of the CJEU. One example is the *Halifax* case (a VAT case) in which for the application of the subjective intention, the CJEU observed that the 'essential aim of the *transactions*' (emphasis added) must be examined. In *Weald leasing*, another VAT case, the CJEU considered (paragraph 30): 'Second, it must also be apparent from a number of *objective factors* that the essential aim of the transactions concerned is to obtain a tax advantage'. In *Thin Cap GLO*,[41] a direct taxation case, the CJEU considered (paragraph 82): 'national legislation which provides for a *consideration of objective and verifiable elements* in order to determine whether a transaction represents a purely artificial arrangement, entered into for tax reasons alone' (emphasis added). The objectified intention test is elaborated further in the case law of the CJEU in the genuine test (also called the economic reality test). In the *Cadbury Schweppes*-case,[42] the CJEU considered in that regard that abuse existed when there were 'wholly artificial arrangements which do not reflect economic reality'. For this, it must be examined whether there were 'objective circumstances' (paragraph 64) that reflect an 'economic reality' (paragraph 65); the CJEU pointed out in that regard to 'objective factors which are ascertainable by third parties with regard, in particular, to the extent to which the (company) physically exists in terms of premises, staff and equipment' (paragraph 67). From *Cadbury Schweppes*, it is also shown that only pointing out a tax benefit is not sufficient to come to the conclusion that

38. CJEU 14 November 2006, C-513/04, *Kerckhaert-Morres*.

39. Different: Koriak, above n. 21; Koriak is of the opinion that there is a restriction, but in that regard, does not discuss the *Kerckhaert–Morres* case, a case that points to another direction. I therefore do not agree with his analyses.

40. *See* Weber (June 2013), above n. 35, part 1, at 253.

41. CJEU 13 March 2007, case C-524/04, *Thin Cap GLO*.

42. CJEU September 2006, case C-196/04, *Cadbury Schweppes*.

this is abuse.[43] It is shown from, amongst others, the *Foggia* case[44] that to answer the question of whether abuse is present, all circumstances must be weighed against each other. A tax benefit (in that case, large losses) cannot in itself be considered decisive (paragraph 39 of Foggia): 'However, the fact that those tax losses are very substantial and that their origin has not been clearly determined may constitute an indicator of tax evasion or avoidance', according to the CJEU. As is shown from *Foggia*, abuse can be even present when an arrangement is not artificial. When the tax benefits are much higher than the (genuine) economic benefit,[45] after having weighed those facts against each other, one can come to the conclusion that the *principal purpose* of an arrangement is to obtain a tax benefit, even if nothing is artificial.

In my view, the economic reality test that can be found in the case law of the CJEU is comparable to the reasonableness test in de OECD PPT rule.[46] In the economic reality test, namely, account is also taken of (i) all relevant facts and circumstances (see, for example, *Thin Cap GLO*); (ii) which must be weighed (*Foggia*); (iii) in an objective analysis (*Cadbury Schweppes*: artificial versus economic reality/genuine); the last objective analysis is present in the case law of the CJEU given that it must be determined whether an arrangement is 'wholly artificial' or if it concerns a 'genuine' arrangement. This should be subjected to an objective assessment: what is genuine in such a situation? What is artificial in such a situation? The answer to this is, to ask yourself what a third (reasonable) person in such a situation should do. This is comparable with the OECD PPT rule: in point 11 of the Commentary it is remarked that 'the determination requires reasonableness suggesting that the possibility of different interpretations of the events must be objectively considered'. It follows from the Commentary, in my view, that the 'facts and circumstances' must be interpreted such as a reasonable (third) person would have interpreted those facts and circumstances. If a reasonable person should qualify certain facts and circumstances as artificial, then the principal purpose of a transaction will have been to obtain a tax benefit. This means that so far the OECD PPT rule and the genuine test from the CJEU case law are comparable. Also, the fact that under the economic reality test of the CJEU, a tax benefit does not constitute abuse as such, is the same as under the OECD PPT (under which referring only to the effects of an arrangement does not constitute abuse).

4.3.2 No Artificiality Required?

The economic reality test in the case law of the CJEU and the PPT rule, however, are not entirely the same: it is defendable that the OECD PPT rule is broader than the genuine test, and that there is not only treaty abuse under the OECD PPT rule in the case of an *artificial* arrangement, but also when there are economic reasons for a transaction but the tax benefits outweigh the economic reasons. As observed here above, it is clear from the *Foggia* case that abuse *without* an artificial arrangement is also possible under the abuse case law of the CJEU, so I expect that also on this point, the CJEU will not have a problem with this broader test. True, it cannot be argued with 100% certainty that the CJEU will permit such a broader test. The *Foggia* case concerned the Merger Directive and the anti-abuse provision in that directive does not contain an explicit artificiality test. The GAAR under the Anti-Tax Avoidance Directive[47] and the GAAR under the Parent–Subsidiary Directive in particular require that there must be artificiality if there is to be abuse.[48] When the CJEU requires an artificiality test under the GAARs of these Directives, the PPT rule must be interpreted in conformity with these Directives, and thus be limited to artificial arrangements alone.

4.3.3 Opinion in Literature

In literature, doubts are raised as to whether the OECD PPT rule does contain an economic reality test and therefore, on this basis, it is defended that the OECD PPT rule is not in accordance with EU law.[49] The European Commission has recommended to the Member States that in the case they include the OECD PPT rule in a tax treaty, the Member State insert herein an explicit 'genuine economic activity' test.[50] I emphasise that for the sake of clarity (and therefore the legal certainty) that this explicit inclusion of such a test should be welcomed, but as said, in my view, the PPT rule already contains such a test. When an arrangement is artificial, it will be, in most cases, also under OECD PPT rule, set up to obtain a tax benefit as one of the principal purposes. The only potential problem I see is that the PPT rule is broader (no artificiality required) compared to the GAAR in the Anti-Tax Avoidance

43. *See* para. 38 of *Cadbury Schweppes*: 'it follows that the fact that in this case CS decided to establish CSTS and CSTI in the IFSC for the avowed purpose of benefiting from the favourable tax regime which that establishment enjoys does not in itself constitute abuse'. *See also* K. Lennaerts, 'The Concept of "Abuse of law" in the Case Law of the European Court of Justice in Direct Taxation', *Maastricht Journal of European and Comparative Law* 329 (2015).
44. CJEU 10 November 2011, C-126/10, *Foggia*.
45. For instance: the tax benefit is EUR 10 million less tax paid and the restructuring saves EUR 30,000 in reduced administrative costs (economic benefit).
46. I agree with Marres/De Groot that the OECD PPT includes a genuine/economic reality test, which is comparable with the test that can be found in the case law of the CJEU regarding abuse of law and is contained in the anti-abuse provision of the Parent–Subsidiary Directive and in the Anti-Tax Avoidance Directive. *See* O.C.R. Marres and I.M. de Groot, De algemene antimisbruikbepaling in de moeder-dochterrichtlijn (deel 1), WFR 2015/7107, at 911.
47. *See* Article 6 of Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.
48. *See* Weber (2016), above n. 5.
49. *See* Koriak, above n. 21, at 556.
50. *See* 28 January 2016, no. C-2016 271 final; Commission Recommendation on the implementation of measures against tax treaty abuse, H&I 2016/48. *See also*, with regard to the main purpose test in the OECD-LOB provision, European Commission, Working document, Brussels 10 September 2014, Taxud D3, Working party IV – Direct taxation, OECD BEPS Action 6 draft: "Limitation On Benefits" provisions – interaction with EU law, at 10, published in Highlights & Insights on European Taxation 2015/395.

Directive and that under the Parent–Subsidiary Directive (see above).

4.3.4 Conclusion

To conclude: In light of the fact that the reasonableness test in the OECD PPT and abuse case law such as is applied by the CJEU *itself* in general are comparable, I doubt whether the CJEU would rule that such a test is in contravention of the EU principle of legal certainty. The only potential problem is that the PPT rule is broader (no artificiality required) as compared to the GAARs in the Anti-Tax Avoidance Directive and the Parent–Subsidiary Directive.

4.4 Does the Reasonableness Test Lead to Too Much Discretion of the Tax Administration?

The question is whether the discretion the tax authorities have in applying the PPT rule is contrary to EU law. According to Kemmeren,[51] the reasonableness test leads to too much uncertainty to taxpayers, and this is contrary not only to the requirement of legal certainty, but also to the *Biehl* case.[52]

4.4.1 Biehl

The *Biehl* case concerned a refund rule for too much tax paid. This rule gave no right to a refund of too much tax paid in the case that a taxpayer was only a resident taxpayer in Luxembourg part of the year, because he had taken up residence in the country or left it during the course of the tax year. The CJEU was of the opinion that this was a matter of a covert form of discrimination against nationality (paragraph 14):

> Even though the criterion of permanent residence in the national territory referred to in connection with obtaining any repayment of an over-deduction of tax applies irrespective of the nationality of the taxpayer concerned, there is a risk that it will work in particular against taxpayers who are nationals of other Member States. It is often such persons who will in the course of the year leave the country or take up residence there.

During the hearing at the Court, the tax administration observed that there exists in Luxembourg law a non-contentious procedure allowing temporarily resident taxpayers to obtain repayment of an over-deduction of tax by adducing the unfair consequences, which the application Luxembourg tax law entailed for them. On this rule, the CJEU observed that, the Luxembourg government 'has not cited any provision imposing an *obligation* on the administration of the contributions to remedy in every case the discriminatory consequences arising for the application of the national provisions at issue' (emphasis added). In his Opinion (point 19), AG Darmon referred to the case law of the CJEU as 'mere administrative practices',[53] 'which by their nature are alterable at will by the authorities and are not given the appropriate publicity, cannot be regarded as constituting the proper fulfilment of obligations under the Treaty'.[54]

It follows from *Biehl* that the CJEU was of the opinion that the Luxembourg non-contentious procedure was not sufficiently legally binding (no obligation) to remove the contravention of EU law. In other words: the rule allowed too much discretionary power to the tax authorities. The tax authorities were able to apply the rule as they thought fit; there was no legal *obligation*.

4.4.2 Biehl versus the Reasonableness Test

The question is whether the discretion that the tax authorities had in *Biehl* is also of importance to the reasonableness test in the PPT rule.

Under the reasonableness test in the PPT rule, the tax authorities also have discretion, in the sense that they are not obliged to apply the PPT rule. In addition, based on the reasonableness test, they must substantiate their assessment on the basis of objective circumstances. Depending on the case, those will always be different circumstances. This, however, is a different situation to that under discussion in *Biehl*. In *Biehl*, there was a matter of a covert discrimination against nationality because taxpayers who exercised the free movement in Luxemburg could not claim a refund of too much tax paid. The Luxembourg government responded to this during the hearing of the Court that this disadvantage could be removed by the Luxembourg non-contentious procedure, but the CJEU dismissed this argument because there was no *obligation* of the tax authorities to apply that procedure. Due to this, the discrimination could thus continue to exist in certain situations.

The PPT rule as such is not contrary to EU law, but the application of the PPT rule can give rise to juridical double taxation, but this, as such, is not contrary to EU law (see on this in paragraph 5.3 here above). *Non*-application of the PPT rule does not lead to a contravention of EU law as such, because the non-application of the PPT rule leads to the application of the tax treaty, and precisely due to this, double taxation could be reduced.

As said, the reasonableness test only emphasises that the tax administration must substantiate their assessment that obtaining a benefit is one of the principal reasons of an arrangement on the basis of an objective analysis of objective circumstances. Assumptions are not permitted. Moreover, an assessment based merely on the effects of an arrangement is not sufficient.

To me, this would not seem to be contrary to the principle of legal certainty; The reasonableness test in fact *underlines* the principle of legal certainty: when a tax treaty is applicable, a taxpayer may invoke the benefits of this treaty, unless, but this must be based on an objective analysis of the facts and circumstances, that obtaining a tax benefit is one of the principal reasons of an arrangement.

51. Kemmeren, above n. 2.
52. CJEU 8 May 1990, C-175/88, *Biehl*.
53. CJEU 4 April 1974, 167/73, *Commission/French Republic* [1974] 359, paras. 46 and 47.
54. CJEU 15 October 1986, *Commission/Italy* [1986] ECR 2945.

4.4.3 Discretion and EU-Law

The *Leur–Bloem* case,[55] in my opinion, is of importance as regards the discretion the tax authorities have.[56] From *Leur–Bloem* it is clear that a discretionary power of the tax administration not to apply EU law on the basis of evasion or abuse (in this case, the fiscal EU Merger Directive) is not permitted. It is clear that otherwise, the principle of legal certainty would be at risk. Specifically, with regard to advance consent or permits/licences, which contain a deviation from the fundamental freedoms, the Court of Justice has developed case law on the basis of which it is clear that an assessment by an administrative body is permitted when 'based on objective, non-discriminatory criteria which are known in advance, in such a way as to circumscribe the exercise of the national authorities' discretion, so that it is not used arbitrarily'.[57] We see a similar judgement regarding the discretionary power of administrative bodies in the area of directives, such as in *Fazenda Pública*.[58] In this case, the Court of Justice considered with regard to the level of discretion of the tax administration under the Sixth VAT Directive,

> [a] distinction must be drawn between the case where a Member State attempts to ensure the transposition of a directive by giving an administrative authority a discretionary power to apply its provisions, without circumscribing the administrative authority's discretion [which is not permitted], and the case, examined here, where the national legislature adopts, in a binding rule of law, the criteria set out in the directive and then leaves it to an administrative authority to implement them. [which is permitted].[59]

If we apply this by analogy to the PPT rule, it cannot be said that the PPT rule is a rule that does not define the exercise of the national authorities' discretion. The fact that the answer to the question of when abuse is present cannot always be answered with 100% certainty beforehand (as it is dependent on the circumstance of each case) is inherent to the concept of 'abuse' itself.[60]

5 Conclusion

The OECD BEPS Action 6 report contains a PPT rule[61] for the purpose of combating abuse of tax treaties. The PPT rule is applicable when 'it is reasonable to conclude' that obtaining a benefit is one of the principal purposes of an arrangement (the reasonableness test).

First, it is held in the literature that the reasonableness test of the PPT rule would be contrary to the European Union's principle of legal certainty. Reference is made in this regard to the judgments of the CJEU in *SIAT* and *Itelcar*. Second, it is held in literature that the OECD PPT rule gives the tax authorities too much discretion and, therefore, is not in line with EU law (based on the *Biehl* case). It is also held in literature that the OECD PPT rule does not contain a genuine economic activity test and therefore, is not in line with EU law.

In this contribution, I have defended that it does not follow from the cases *SIAT* and *Itelcar* that the reasonableness test is contrary to the principle of legal certainty. Those authors who hold a different view take, in my view, the relevant grounds of those judgments out of the context of the case. When they are read in the context of the case, one must come to the conclusion that those cases cannot be applied to the PPT rule.

The reasonableness test is also not contrary to EU law because this gives too much discretion to the tax authorities. The reasonableness test in fact *underlines* the principle of legal certainty: when a tax treaty is applicable, a taxpayer may invoke the benefits of this treaty, unless – but this must be based on an objective analysis of the facts and circumstances – obtaining a tax benefit is one of the principal purposes of an arrangement.

Finally, in light of the fact that the reasonableness test in the OECD PPT rule and the abuse case law as applied by the CJEU *itself* in general are comparable, I doubt whether the CJEU would rule that such a test is in contravention of the EU principle of legal certainty or with another principle in EU law. The only potential problem I see is that the OECD PPT rule is broader (no artificiality required) compared to the GAARs in Anti-Tax Avoidance Directive and the Parent–Subsidiary Directive.

55. CJ 17 July 1997, case C-28/95 (*Leur-Bloem*), para. 44.
56. This part is based on: Dennis Weber and Thidaporn Sirithaporn, 'Legal Certainty, Legitimate Expectations, Legislative Drafting, Harmonization and Legal Enforcement in European Tax Law', in Brokelind (ed.), *Principle of Law: Function, Status and Impact in EU Tax Law, IBFD* (2014), at 235.
57. *See*, amongst others, ECJ 12 July 2001, case C-157/99 (*Smits en Peerbooms*), ECR I-5473, para. 90.
58. CJ 14 December 2000, case C-446/98 (*Fazenda Pública*), ECR I-11 435.
59. *Id*., para. 34.
60. *See* D. Weber, *Tax Avoidance and the EX Treaty Freedoms*, EUCOTAX, Kluwer Law International (2005), at 234.
61. *See* BEPS Action 6, above n. 1.

Post-BEPS Tax Advisory and Tax Structuring from a Tax Practitioner's View

Paul Lankhorst & Harmen van Dam*

Abstract

The international tax landscape is changing and it is changing fast. The political perception is that taxation of multinational enterprises is not aligned with the 'economic activity' that produces their profits (i.e. not aligned with 'value creation'). The perception links 'value creation' with 'employees and sales'.

In the BEPS Project of the OECD, the OECD attempts to combat base erosion and profit shifting and to align taxation with value creation. In this article, the authors discuss the impact they expect BEPS to have on tax advisory and tax planning. The focus goes to BEPS Actions 7, 8-10 and 13.

By maintaining the separate entity approach under BEPS for the taxation of multinationals, has the OECD been forced to 'stretch' existing rules beyond their limits? Will the created uncertainty lead to a shift from 'aggressive tax planning' by multinationals to 'aggressive tax collection' by tax administrations? Will the role of tax advisory change from advising on the lowest possible effective tax rate to a broader advice including risk appetite and public expectations?

Keywords: BEPS, value creation, tax structuring, international taxation

1 Introduction

1.1 Background

The international tax landscape is changing and it is changing fast.[1] In 2013, the OECD and G20 countries adopted a 15-point Action Plan to address Base Erosion and Profit Shifting (BEPS).[2] On 5 October 2015, the OECD published the Final BEPS package for reform of the international tax system to tackle tax avoidance.[3] In 2014, the Fiat, Apple and Starbucks cases showed that the European Commission started to actively use state aid rules to combat tax avoidance.[4] On 30 August 2016 the European Commission concluded that Ireland granted Apple tax advantages amounting to EUR 13 billion.[5] There is no doubt that the changing tax landscape influences tax advisory and tax planning. In this article we discuss the impact of these changes on the role of tax planning and tax advisory already existing and for the future. By maintaining the separate entity approach under BEPS for the taxation of multinationals, has the OECD been forced to 'stretch' existing rules beyond their limits? Will the created uncertainty lead to a shift from 'aggressive tax planning' by multinationals to

* Paul Lankhorst, MSc LLM, is tax adviser at Loyens & Loeff. Harmen van Dam, LLM, is tax partner at Loyens & Loeff.

1. *See* OECD, *Addressing Base Erosion and Profit Shifting* (2013), at 47.
2. *See* OECD, *Action Plan on Base Erosion and Profit Shifting* (2013).
3. *See* OECD, *Explanatory Statement, OECD/G20 Base Erosion and Profit Shifting Project* (2015) (hereinafter Explanatory Statement); OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report* (2015) (hereinafter Action 1 Report); OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report* (2015) (hereinafter Action 2 Report); OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report* (2015) (hereinafter Action 3 Report); OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2015 Final Report* (2015) (hereinafter Action 4 Report); OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report* (2015) (hereinafter Action 5 Report); OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report* (2015) (hereinafter Action 6 Report). OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 – 2015 Final Report* (2015) (hereinafter Action 7 Report). OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 Final Reports* (2015) (hereinafter Action 8-10 Reports). OECD (2015), *Measuring and Monitoring BEPS, Action 11 – 2015 Final Report* (2015) (hereinafter Action 11 Report); OECD, *Mandatory Disclosure Rules, Action 12 – 2015 Final Report* (2015) (hereinafter Action 12 Report); OECD, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 – 2015 Final Report* (2015) (hereinafter Action 13 Report); OECD, *Making Dispute Resolution Mechanisms More Effective, Action 14 – 2015 Final Report* (2015) (hereinafter Action 14 Report); OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 – 2015 Final Report* (2015) (hereinafter Action 15 Report).
4. *See e.g.* Commission Decision of 17 October 2014, OJ C 369 SA.38373 (hereinafter Apple Case); Commission Decision of 21 October 2015, OJ L 351 SA.38375 (hereinafter Fiat Case); Commission Decision of 6 February 2015, OJ C 44 SA.38944 (hereinafter Amazon Case); Commission Decision of 21 October 2015, OJ L 83 SA.38374 (hereinafter Starbuck Case). For some analysis from a US perspective of these Commission initiatives, *see* U.S. Department of the Treasury, 'The European Commission's recent state aid investigations of transfer pricing rulings', *White Paper* (2016).
5. European Commission, 'State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to €13 billion' (2016), available at <http://europa.eu/rapid/press-release_IP-16-2923_en.htm> (last visited 20 June 2017).

'aggressive tax collection' by tax administrations? Will the role of tax advisory change from advising on the lowest possible effective tax rate to a broader advice including risk appetite and public expectations?

1.2 Research Question

In this article we answer the following question:

> As tax practitioners, which impact do we expect from BEPS on the role of tax structuring and tax advisory of MNEs?

The political perception is that taxation of multinational enterprises (MNEs) is not aligned with the 'economic activity' that produces their profits (i.e. not aligned with 'value creation).[6] The perception links 'value creation' with 'employees, assets, and sales'.[7] BEPS Action 7 (Preventing the artificial avoidance of permanent establishment status)[8] and Actions 8-10 (Aligning transfer pricing outcomes with value creation)[9] attempt to address this issue. Therefore, our focus goes to these topics. Actions 8-10 are expected to have a big impact because they change the fundamentals underlying the arm's length principle and have direct impact without the need of further implementation.[10] Although Action 7 requires implementation through tax treaties (or the multilateral instrument),[11] we expect a substantial impact because it lowers the threshold of taxable presence in a country.[12] In a globalising world where decision-making is not centralised in one location but spread across the globe, many MNEs will be faced with (discussions about) the presence of permanent establishments.[13] Action 13 (Transfer pricing documentation and country-by-country reporting)[14] have the biggest impact on tax structuring and tax advisory will give tax administrations full insight into the transfer pricing strategies of MNEs, forcing them to have defendable tax structures and responding quickly to BEPS. We also expect that Action 6 (Preventing the granting of treaty benefits in inappropriate circumstances)[15] will have a big impact, since it denies treaty benefits in many situations where such benefits are currently available. Based on our areas of expertise, we left this element open for further research. The expected consequences specifically related to Action 6 require further investigation.

To answer the research question, we first discuss the proposed measures of BEPS Actions 7, 8-10 and 13 and the consequences we expect these measures to have on tax advisory and tax structuring. We then discuss three issues of international corporate taxation that BEPS does not address.

2 Expected consequences of BEPS

2.1 Introduction

In this section we explain which consequences we expect from the outcomes of the implementation of the BEPS in the international corporation tax systems of countries. Before being able to do so, it is necessary to briefly describe the proposed measures of BEPS, which we expect to have the biggest impact. As described in Section 1.2, this concerns Actions 8-10, Action 7 and Action 13. For these Actions, we will first describe the most important observations and we will then describe the consequences we expect from these observations.

2.2 Actions 8-10

2.2.1 Aligning Transfer Pricing Outcomes with Value Creation

The arm's length principle is used by countries as the cornerstone of transfer pricing rules.[16] The OECD provides guidance on the interpretation of the arm's length principle in the OECD Transfer Pricing Guidelines (OECD Guidelines).[17] In its effort to combat BEPS, the OECD was of the view that the guidance on the arm's length principle needed to be *clarified and strengthened*.[18] Actions 8-10 give the 'clarification' proposed by the

6. *See e.g.*, Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, PB L 193, at 1; OECD, 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting' (2016), available at <www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf> (last visited 20 June 2017), at 1. *See* for a comparison Y. Brauner, 'BEPS: An Interim Evaluation', 6 *World Tax Journal* 1, at 32 and 38 (2014). At 38: *'… for transfer pricing, the OECD has (unprecedently) produced what sounds like a principle: allocation of tax base according to value creation.'*
7. *See* for the discrepancy with regard to sales, *e.g.* BBC, 'Starbucks Paid Just £8.6m UK Tax in 14 Years' (2012), available at <www.bbc.com/news/business-19967397> (last visited 20 June 2017). *See* for the value creation with regard to employees, *e.g.* Action 8-10 Report (2015), above n. 3; Dutch Decree of 15 January 2011, no. IFZ2010/457M, at 5. Payroll and assets would represent the supply view of income production, and corporate sales would represent the demand view of income production. *See* for an analysis P.B. Musgrave, 'Principles for Dividing the State Corporate Tax Base', in: C.E. McLure Jr. (ed.), *The State Corporation Income Tax: Issues in Worldwide Unitary Combination* (1984), at 228-46. *See* for extensive analyses also M.F. de Wilde, *Sharing the Pie: Taxing Multinationals in a Global Market*, diss. Erasmus University Rotterdam (2015), available at <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2564181> (last visited 20 June 2017) (Ch. 6).
8. *See* Action 7 Report, above n. 3.
9. *See* Action 8-10 Reports, above n. 3.
10. Many countries directly apply the OECD Guidelines.
11. On 24 October 2016, the OECD published the text of the 'Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting'. The treaty is now open for ratification.
12. *See* for some analysis M. de Wilde, 'Lowering the Permanent Establishment Threshold via the anti-BEPS Convention: Much Ado About Nothing?', to be published in *Intertax*.
13. *Ibid*.
14. *See* Action 13 Report, above n. 3.
15. *See* Action 6 Report, above n. 3.
16. The arm's length standard can be found in the equivalents of Art. 9 OECD Model Tax Convention in the double tax conventions of countries.
17. *See* OECD, *OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (2010), revised in: OECD (2015) Action 8-10 Reports, above n. 3.
18. *See* Action 8-10 Reports, above n. 3, at 9-10.

OECD and focuses on intangibles, risks and re-characterisation of transactions.[19]

2.2.2 Most Important Observations in Relation to Actions 8-10

We deem the following observations to be the most important conclusions of Actions 8-10:

1. Actions 8-10 stretch the arm's length principle beyond its boundaries by putting economic concepts of what third parties should do according to economic theories above what third parties actually do;
2. Actions 8-10 imply that contracts are irrelevant, which stretches arm's length principle to the extent that it almost resembles a formulary apportionment based on functionality;
3. Actions 8-10 use vague concepts to draw conclusions.

Below we explain where Actions 8-10 implicitly or explicitly draw these conclusions. Subsequently we will explain which consequences this has on the tax planning of MNEs.

- Ad 1. Actions 8-10 stretch the arm's length principle by putting economic concepts of what third parties should do according to economic theories above what third parties actually do

Although a more fundamental solution to tackle BEPS is in our view preferred (see Section 3), the OECD intends to maintain the arm's length principle as cornerstone for transfer pricing rules.[20] Nonetheless, the OECD acknowledges that under existing interpretations of the arm's length principle, it may provide opportunities for base erosion and profit shifting.[21] Actions 8-10 are presented as a clarification of how the arm's length principle should be interpreted.[22] But Actions 8-10 go further than that. As we will demonstrate below, the 'clarification' of the arm's length principle given by the OECD stretches the arm's length principle beyond its historic meaning by shifting from looking at what independent entities actually do to what independent entities should do according to economic theory.

To demonstrate this, we go back to the basics of the arm's length principle and look at the wording of Article 9(1) of the OECD Model Convention (OECD Model):

> Where a) an enterprise of a Contracting State participates directly or indirectly in the management, control or capital of an enterprise of the other Contracting State, or b) the same persons participate directly or indirectly in the management, control or capital of an enterprise of a Contracting State and an enterprise of the other Contracting State, and in either case conditions are made or imposed between the two enterprises in their commercial or financial relations *which differ from those which would be made between independent enterprises*, then any profits which would, but for those conditions, have accrued to one of the enterprises, but, by reason of those conditions, have not so accrued, may be included in the profits of that enterprise and taxed accordingly. (emphasis added; HvD and PL)

It follows from the wording of Article 9(1) that a comparison should be drawn with the conditions made or imposed between independent enterprises. As such, one complies with the arm's length principle if one acts as independent enterprises also do. Actions 8-10 deviate from this basic principle of the arm's length principle. Below we give two examples.

<u>Example 1. Requirement to demonstrate completely rational behaviour</u>

In its guidance on re-characterisation of transactions, Actions 8-10 state that 'The transaction […] may be disregarded […] where the arrangements made in relation to the transaction, viewed in their totality, differ from those which would have been adopted by independent enterprises *behaving in a commercially rational manner* in comparable circumstances.'[23] It follows from this statement that the OECD does not simply require that related companies act in line with arrangements that would have been adopted by independent enterprises, but that it adds the criterion of commercial rationality to the arm's length principle: the OECD intends to look at what independent enterprise would do if they would act in a commercially rational manner.

What independent enterprises would do if they acted in a commercially rational manner differs from what independent enterprises actually do. Nobel Prize winner Daniel Kahneman has shown that, in reality, the assumption of rational economic decision-making is false.[24] The examples given by Kahneman show that irrational decision-making is very common. A group of 200 respondents were asked the following:

> Imagine that you have decided to see a play and paid the admission price of $ 10 per ticket. As you enter the theatre, you discover that you have lost the ticket. Would you pay $ 10 for another ticket?

46% of the respondents answered with yes, 54% with no. Then a group of 183 respondents were asked the following:

> Imagine that you have decided to see a play and paid the admission price of $ 10 per ticket. As you enter

19. *Ibid*.
20. *See* OECD, 'BEPS – Frequently Asked Questions', available at <www.oecd.org/ctp/beps-frequentlyaskedquestions.htm#Action8?> (last visited at 20 June 2017) at no. 54.
21. *See Ibid*. at no. 55 and 108. *See also* for a short analysis of the weaknesses and strengths of the arm's length principle: O. Treidler, 'The Arm's Length Principle in the Times of BEPS' (2016), *Discussion Paper*, available at <DOI:10.13140/RG.2.1.1937.1286> (last visited 20 June 2017), at 3-4.
22. *See* Action 8-10 Reports, above n. 3. The OECD's Action Reports on transfer pricing have been incorporated in the OECD's Transfer Pricing by decision of the OECD Council on 23 May 2016.
23. *See* OECD (2015), above n. 17, at 39-40.
24. *See* D. Kahneman, 'New Challenges to the Rationality Assumption', 150, *Journal of Institutional and Theoretical Economics* no. 1 (1994) at 18-36.

> the theatre, you discover that you have lost a $ 10 bill. Would you pay $ 10 for a ticket to the play?

88% of the respondents answered with yes, 12% with no. Although the outcome of both scenarios is identical, the respondents gave different answers. As follows from this example and many other examples given by Kahneman, human behaviour is subject to limited rationality.[25] It does therefore not fit within the arm's length principle to require full rationality in intragroup transactions where third party transactions are characterised by limited rationality.

Example 2. Requirement to analyse all options realistically available

Another topic where Actions 8-10 replace actual behaviour of independent enterprises with economic concepts of what independent enterprises should do according to economic theory is the requirement to always choose the 'best option realistically available'. Actions 8-10 state that

> Independent enterprises, when evaluating the terms of a potential transaction, will compare the transaction to the other options realistically available to them, and they will only enter into the transaction if they see no alternative that offers a clearly more attractive opportunity to meet their commercial objectives.[26]

In reality, people will more readily choose the option that is 'good enough' rather than the best option out of those available.[27] Human beings make their economic decisions mainly on the basis of heuristics (rules of thumb) and not on the basis of well-considered choices between all of the options available. By requiring to choose the best option out of all options realistically available, the OECD deviates from actual human behaviour.

In conclusion, human behaviour is marked by limited rationality and opportunism. It would therefore be inappropriate to impose economic concepts on transactions between associated enterprises where (the board members of) independent enterprises do not follow these economic concepts. The arm's length principle's purpose is to allocate the right to tax the profits that an MNE actually makes and not to enable tax authorities to tax profits that an associated enterprise could have made if it behaved according to certain prescriptive economic theories.[28]

- Ad 2. OECD implies that contractual arrangements are irrelevant, which stretches arm's length principle to the extent that it almost resembles a formulary apportionment based on functionality

Under the arm's length principle, transactions are priced taking into account functions performed, assets owned and risks assumed.[29] Actions 8-10 give an interesting interpretation of how to allocate risks and assets. With regard to risks assumed, Actions 8-10 state that risks contractually assumed by a party that cannot in fact exercise meaningful and specifically defined control over the risks, or does not have the financial capacity to assume the risks, will be allocated to the party that does exercise such control and does have the financial capacity to assume the risks.[30]

The OECD developed a step plan to determine to which entity it deems to assume the risks for the purpose of a transfer pricing analysis. This is not necessarily the entity that contractually incurs the risks. On the contrary, under BEPS 8-10 contractual arrangements seem to have become irrelevant. The OECD developed the following step plan to allocate risks for the purpose of a transfer pricing analysis:[31]

1. Identify economically significant risks with specificity;
2. Determine how the risks are contractually assumed by the enterprises under the terms of the transaction;
3. Determine through a functional analysis how the associated enterprises that are parties to the transaction operate in relation to assumption and management of the specific, economically significant risks, and in particular which enterprise or enterprises perform control functions and risk mitigation functions, which enterprise or enterprises encounter upside or downside consequences of risk outcomes, and which enterprise or enterprises have the financial capacity to assume the risk;
4. Steps 2-3 will have identified information relating to the assumption and management of risks in the controlled transaction. The next step is to interpret the information and determine whether the contractual assumption of risk is consistent with the conduct of the associated enterprises and other facts of the case by analysing (i) whether the associated enterprises follow the contractual terms […]; and (ii) whether the party assuming risk, as analysed under (i), exercises control over the risk and has the financial capacity to assume the risk
5. Where the party assuming risk under steps 1-4(i) does not control the risk or does not have the financial capacity to assume the risk, apply the guidance on allocating risk. The guidance on allocating risk refers to functions (see below). In other words: step 3 prevails over step 2.

25. D. Kahneman, *Thinking, Fast and Slow* (2011), at 368-9.
26. *See* Action 8-10 Reports, above n. 3, at 16.
27. As demonstrated by H. Simon, *see e.g.* G. Fellner, W. Güth & E. Martin, 'Satisficing or Optimizing? An Experimental Study', *Discussion Paper on Strategic Interaction* (2006); T. Hindle, *Guide to Management Ideas and Gurus* (2008).
28. For more information, *see* M.A. de Lange, R. Hafkenscheid & P. Lankhorst, '(Non-)Recognition of Transactions between Associated Enterprises: on Behaving in a Commercially Rational Manner, Decision-Making Traps and BEPS', 22 *International Transfer Pricing Journal* no. 2 (2015).
29. OECD (2010), above n. 17, at 43.
30. *See* OECD (2010), above n. 17, at 243-46.
31. OECD (2015), above n. 17, at 22.

6. The actual transaction as accurately delineated by considering the evidence of all the economically relevant characteristics of the transaction […], should then be priced taking into account the financial and other consequences of risk assumption, as appropriately allocated, and appropriately compensating risk management functions.

The step plan does not explicitly state that contractual arrangements are irrelevant: Step 2 states that the contractual arrangements should be reviewed as part of the analysis. That contracts are considered irrelevant follows from the remainder of the step plan. If step 2 is not consistent with step 3, step 3 prevails. As such, step 3 always determines allocation of risk. Under step 3, there are three elements that determine risk allocation: (i) who performs and controls functions in relation to the risk, (ii) who encounters the upsides and downsides of the risk and (iii) who has the financial capability to assume the risk. The first element clearly ignores contractual arrangements. At first sight, the second and third element seem to depend on contractual arrangements. A closer look at the guidance of Actions 8-10 shows that this is only an illusion.

Hafkenscheid has demonstrated that the questions of who encounters the upsides and downsides of the risk and who has the financial capability to assume the risk, are linked to functionality in Actions 8-10.[32] In summary, this follows from paragraphs 1.85 and 1.103 of Actions 8-10. Paragraph 1.85 together with 1.103 concludes that a company (Company A) that is the legal owner of an asset, but does lack capability to decide on whether to invest in the particular asset, and whether and how to protect its investment including whether to dispose of the asset, is only entitled to a risk-free return on its investment:

> Company A does not have control over the economically significant risks associated with the investment in and exploitation of the asset, and those risks should be aligned with control of those risks by Companies B and C. The functional contribution of Company A is limited to providing financing for an amount equating to the cost of the asset that enables the asset to be created and exploited by Companies B and C. However, the functional analysis also provides evidence that Company A has no capability and authority to control the risk of investing in a financial asset. Company A does not have the capability to make decisions to take on or decline the financing opportunity, or the capability to make decisions on whether and how to respond to the risks associated with the financing opportunity. Company A does not perform functions to evaluate the financing opportunity, does not consider the appropriate risk premium and other issues to determine the appropriate pricing of the financing opportunity, and does not evaluate the appropriate protection of its financial investment. […] Company A would not be entitled to any more than a risk-free return as an appropriate measure of the profits it is entitled to retain, since it lacks the capability to control the risk associated with investing in a riskier financial asset. The risk will be allocated to the enterprise which has control and the financial capacity to assume the risk associated with the financial asset.

The OECD uses a similar reasoning with regard to ownership of intangible assets. Paragraph 6.35 of the OECD's Transfer Pricing Guidelines states that legal rights and contractual arrangements form the starting point for any transfer pricing analysis involving intangibles.[33] One would again expect that this means that contractual arrangements are considered relevant. However, Actions 8-10 continue by stating that 'while determining legal ownership and contractual arrangements is an important first step in the analysis, these determinations are separate and distinct from the question of remuneration under the arm's length principle'.[34] The contractual right to exploit an intangible does not – according to the OECD – give any right to retain returns on the intangible. The legal owner of intangibles is only entitled to all returns derived from the exploitation of the intangibles, if it performs all the *functions* related to the development, enhancement, maintenance, protection and exploitation (DEMPE) of the intangibles.[35] If the legal owner neither controls nor performs these so-called DEMPE functions, the legal owner would not be entitled to any ongoing benefit attributable to the outsourced functions. The OECD ignores that in third party transactions, the owner of an asset is often entitled to the returns on that asset, even without having the aforementioned capabilities. In third party transactions, the return depends on the scarcity of the asset.

As an example, one can think of the owner of capital that hires an asset manager to invest its capital. The asset manager has the capability to decide on whether to invest in a particular asset, and whether to dispose of the asset. Would the owner of the asset be merely entitled to a risk free return on its capital, while the asset manager retains all remaining results?

Another example concerns the image rights of famous football players. One would not expect the football player to perform the functions related to the exploitation of the rights itself, but to hire an agent to perform these functions on a commission basis.

From the observations above, it can be concluded that under BEPS Actions 8-10, a functional analysis taking into account functions performed, assets used and risks assumed still forms the basis of a transfer pricing analysis. However, the assumption of risks and the ownership of assets follows the functions performed in relation to the risks and assets. As a consequence, with Actions 8-10 the OECD reduced the traditional functional anal-

32. *See* R.P.F.M. Hafkenscheid, 'Het BEPS-rapport over risicoallocatie: niet zo functioneel', *WFR* 2016/99.

33. OECD (2015), above n. 17, at 75.

34. *Ibid.*, at 76.

35. *Ibid.*, at 78.

ysis from an analysis of functions, assets and risks, to merely an analysis of functions.

By focusing the functional analysis only on functions performed, the OECD does not follow economic principles of how profits are divided between factors contributing to the profit. Economics is the study of how people choose to allocate their scarce resources.[36] It is therefore remarkable that the OECD guidance does not take into account the scarcity of the various factors contributing to profit when stating that most emphasis is to be put on functions. Actions 8-10 ignore the basic principles of economics by only allocating value to functions instead of looking at the scarcity of all production factors (see also Section 3.1).[37]

All in all, while pretending to maintain the arm's length principle as leading principle for transfer pricing, the OECD stretches the interpretation of the arm's length principle to the extent that it almost resembles a formulary apportionment based on functionality.

That the OECD implies that contracts are irrelevant in a functional analysis, does not mean that the importance of concluding intercompany agreements decreases. On the contrary, as we will explain in Section 2.2.3, concluding intercompany agreements has become even more important than before.

- Ad 3. The OECD uses vague concepts to draw conclusions

Examples of vague concepts

Actions 8-10 use vague concepts to explain how in the view of the OECD the arm's length principle should be interpreted.

An important example is the primacy of the 'actual conduct' of the parties in a transaction over the contractual relationship as proposed in paragraph 1.88.[38] In practice, the actual conduct of people deviates substantially from what they should be doing based on, for example, job descriptions and management reporting lines. In practice, whom of the employees in an MNE makes the actual decisions is driven by various circumstances, such as personal impact or the informal power of a staff member, which person of the staff has invented an idea, who has the capacity, capability, energy and spirit to put that idea into practice. The result thereof is that taking the 'actual conduct' of parties as starting point (i) makes it practically impossible to draw conclusions on who is doing what as this differs all the time, and (ii) potentially leads to random outcomes and thus windfall profit allocations. In many situations it will be impossible to 'trace' all steps in the invention of a successful idea, let alone how the decisions about implementing an idea are actually made. To avoid the impracticalities of looking at actual conduct of people, people invented the use of contracts as a means of establishing relations between parties. Deviating from such contractual relations and requiring that profit be allocated based on actual conduct creates uncertainty and the risk of diverging conclusions on what the 'actual conduct' of parties has been.

Another example is the guidance that is given regarding synergy benefits. Actions 8-10 state that 'if important group synergies exist and can be attributed to *deliberate concerted group actions*, the benefits of such synergies should *generally* be shared by members of the group in proportion to their contribution to the creation of the synergy.' (emphasis added)[39] The notion of 'deliberate concerted group actions' is sufficiently vague to create discussions on whether a certain synergy benefit is caused by such deliberate concerted group action. For example, are synergy benefits derived from centralising production in one plant deliberate concerted group actions? The benefit that a group member obtains by being able to borrow at more favourable conditions by reason of having a credit rating that is higher than it would be if it was unaffiliated, is apparently not considered to be attributable to deliberate concerted actions: following the OECD Guidelines such a benefit is allocated to the group member attracting the financing and is not shared between the members of the group contributing to the higher credit rating.[40] But also in cases whether it is clear that there have been deliberate concerted group actions, Actions 8-10 only indicate that the synergies created by this actions should 'generally be shared among members of the group'. This implies that there are exceptions to the main rule. Our personal experience as tax practitioners is that the extraordinary cases are the main source of discussions with tax authorities, but no guidance is provided in Actions 8-10 on cases that deviate from what 'generally' happens.

Deviating interpretation by different countries

The goals that different OECD countries want to realise with BEPS are not aligned. Especially the goals of the US and the European Union seem to deviate. In an interview with BNA, the US Deputy Assistant Treasury Secretary for International Tax Policy Robert Stack indicates that some countries were concerned that the rules on risk, capital and control were previously not clear, and therefore felt the need to re-characterise transactions, but that the US managed to establish that the rules on re-characterisation have not materially changed. Mr Stack indicates that it is still the intention of the US that contracts are respected: 'we spend a lot of time trying to build up the notion that if there is a contract and tax authorities are able to see that parties act in accordance with the contract, they respect the real deal'.[41] This differs from the conclusion that Actions 8-10 intend to focus on functions, not on contracts.

36. M.L. Katz and H.S. Rosen, *Microeconomics* (1998), at 2.
37. In addition to looking at this 'supply side' of profit generation, the demand side (revenue) should be considered. *See* for a comparison Musgrave, above n. 7, at 228-46.
38. OECD (2015), above n. 17, at 31-2.
39. *Ibid.*, at 48.
40. OECD (2010), above n. 17, at 7.13.
41. Bloomberg BNA, 'Robert Stack Discusses U.S. Participation in International Tax Fora and U.S. Tax Reform', available at <https://www.bna.com/robert-stack-deputy-m17179936316/> (last visited 25 June 2017).

Interpretation differences with non-OECD countries will remain in place.[42] An important example is the application of the arm's length principle to 'location benefits'. Non-OECD countries such as China (even though participating in BEPS) are known to have deviating views on location benefits from most OECD countries.[43] China applies a broad concept of location benefits, which includes for example the general preference of Chinese consumers for foreign automotive brands.[44] China may take the position that the additional sales realised as a result of this preference are taxable in China, while OECD countries may claim that these additional profits originate from the ownership of the brand name.[45] While the OECD countries in this example focus at the 'supply side' of profit generation, China focusses more on the demand side (revenue).[46]

2.2.3 Consequences

We expect that stretching the arm's length principle, ignoring contracts and using vague concepts has consequences for (i) tax structuring, and (ii) tax advisory.

- Ad (i) Tax structuring

More disputes with tax authorities

Provoked by the ambiguous guidance on how associated enterprises should price their transactions in order to comply with the arm's length principle and feeling supported by public opinion, some tax authorities will be tempted to argue that more profits should be allocated to them.[47] Not being able to enforce or rely on unambiguous and consistent guidance, and keeping in mind the deviation of the OECD Guidelines from actual behaviour of independent enterprises, many uncertainties will arise for MNEs.

Shift of functions away from high-tax countries

We expect that MNEs will be reluctant to allocate large profits to empty cash boxes (including IP companies), knowing that they will be confronted with disputes with tax authorities feeling supported by the OECD guidance. Refrained from using empty cash boxes, MNEs would be tempted to – notwithstanding the lack of business needs – centralise functions (potentially to tax friendly locations) to reduce the uncertainty of how different countries will interpret the arm's length principle. As discussed in Section 3.2, corporation tax is already considered to be among the most distorting taxes. Triggering MNEs to 'artificially' centralise functions in tax friendly locations might hamper business and trigger relocation of jobs, harming the economy.

Reduced value of the OECD Guidelines

The interpretation of Actions 8-10 deviates from economic reality and uses vague concepts such as 'actual conduct'. Stretching the arm's length principle beyond its limits in this way diminishes the value the OECD guidelines traditionally have had in the practical application of the arm's length principle. Tax courts in various jurisdictions will perceive the ambiguous guidance that does not conform to economic reality as a less reliable source of information for resolving tax disputes. This effect is strengthened by the limited democratic foundation of the OECD Guidelines. In many countries, the OECD Guidelines are merely recommendations of an intergovernmental organisation.[48]

New tax planning opportunities

The diminishing authority will lead to differences in interpretation and application of the arm's length principle between jurisdictions, leading to more instead of less opportunities to exploit differences between countries. Tax courts in some countries may fully apply the new OECD Guidance, while tax courts in other countries may maintain a more strict interpretation of the arm's length principle. This inevitably creates disparities in the interpretation of the arm's length principle, causing undesirable tax planning opportunities for MNEs.

Different goals and interpretations by different countries create mismatches in the interpretation of the arm's length principle. New tax planning opportunities arise on which no common knowledge has yet been developed.

- Ad (ii) Tax advisory

Advice more intragroup agreements

The more opportunistic behaviour of tax authorities will lead to more disputes between MNEs and tax authorities. In addition, not being able to rely on unambiguous and consistent guidance will force MNEs to thoroughly document the reasons for all their transactions and the arguments why the price of the transaction is arm's length to be prepared for potential discussions. Although in the reasoning of Actions 8-10 contracts are irrelevant for the determination of an arm's length remuneration, MNEs will be impelled to conclude intragroup contracts to formally document and leave no doubt about the roles and responsibilities of each party in a transaction. This will be helpful in defending the roles and responsibilities of the parties in court against claims that the roles and responsibilities were different based on actual conduct.

Broader advisory role towards taxpayers

Our personal expectation as tax practitioners is that tax advisers will be more involved in advising clients on

42. There are several differences between the approach of the United Nations and the OECD, *see* United Nations, *Practical Manual on Transfer Pricing for Developing Countries* (2013), chapter 10; OECD (2015), above n. 3.
43. *See* United Nations, above n. 42, at 376-79, 387-88.
44. *Ibid.*, at 377.
45. M.A. de Lange and P.W.H. Lankhorst, 'The Impact of Location Advantages on the Transfer Pricing of Multinationals: On the Chinese Love for European Designer Handbags and Lower Production Costs in India', 21 *International Transfer Pricing Journal* 4 (2014).
46. *See* Musgrave, above n. 7.
47. *See* for a comparison in view of PE profit attribution in response to the lowering of PE thresholds with a view to Action 7; De Wilde, above n. 12, at Sec. 4.3.
48. *See also* R. Luja, 'Fiscale rulings en staatssteun', *Nederlands Juristenblad* 14 (2015), at 870.

conscious decision-making and awareness when it comes to tax planning. We refer to Section 3.3 for guidance on creating awareness of MNEs attitude towards tax planning.

More critical role towards positions taken by tax authorities

As stated above, some tax authorities will be tempted to argue that more profits should be allocated to them provoked by the ambiguous guidance on how associated enterprises should price their transactions. In our personal observations as tax practitioners, the new OECD guidance has already been accepted by some advisers as the only correct interpretation of the arm's length principle. In our view, it is the role of the tax adviser to critically analyse the positions taken by tax authorities and not simply accept positions taken by tax authorities (also ex ante) as the 'truth'.

2.3 BEPS Action 7

2.3.1 Lowering the Threshold for Taxable Presence

Under Article 7 of the OECD Model Convention, business profits of foreign enterprises are only taxable in a country if the foreign enterprise has a PE in that country to which the profit is attributable. Article 5 of the OECD Model Convention contains a definition of permanent establishment. Action 7 attempts to prevent the artificial avoidance of permanent establishments by changing this definition in the Model Convention.

Currently, Article 5(5) OECD Model Convention states that where a person habitually uses the authority in a contracting state to conclude contracts in the name of a foreign enterprise, that foreign enterprise shall be deemed to have a PE in that state. As such, Article 5(5) depends on the formal conclusion of contracts in the name of the foreign enterprise. By arranging that the commissionaire does not have such an authority, the foreign enterprise can avoid having taxable presence in the other country.

Action 7 proposes to change the definition of permanent establishment in three areas: commissionaire arrangement, the exception for auxiliary activities and splitting up contracts to avoid PE status.[49] We expect most impact from the proposals regarding commissionaire arrangements. Action 7 proposes to lower the threshold of a permanent establishment by extending the definition of the deemed permanent establishment to persons habitually concluding contracts that are to be performed by the enterprise, or habitually playing the principal role leading to the conclusion of such contracts which are routinely concluded without material modification by the enterprise.

The OECD notes that common tax avoidance strategies use commissionaire arrangements to shift profits out of the country where the sales take place, without a substantive change in the functions performed in that country (but with a change of risks reducing the arm's length remuneration). In line with Actions 8-10,[50] Action 7 thus attempts to align profit allocation with value creation (whereby value creation is interpreted as people functions).[51] Unlike Actions 8-10, Action 7 does not ignore contractual allocation of risk, but creates taxable presence of the entity that contractually assumes the risk in the country where the sales are made.[52]

Based on Action 7 a PE will be deemed to exist where an agent plays an important role in the conclusion of contracts between the principal and the customers.

2.3.2 Most Important Observations in Relation to Action 7

If and when implemented, MNEs using commissionaire arrangements may be confronted with PEs of their principal company in the commissionaire states. Although Action 7 uses commissionaire arrangements as a primary example, we expect that it will have a broader impact than only commissionaire structures. In each situation where decisions that bind legal entities, or decisions that play an important role in binding legal entities, are made outside of the country of residence of a legal entity, the extended PE definition may trigger discussions about the presence of a PE.

Decisions that bind legal entities, or decisions that play an important role in binding legal entities, were historically often made by the local management of the respective legal entity. For efficiency reasons, there is trend that not all relevant capabilities to make business decisions are present in each separate affiliate (see Section 3.1). Instead, legal entities will use capabilities available elsewhere in the group to assist in decision-making. This process is facilitated by a globalising world that offers flexibility in where people perform their functions. As a result, we more and more see that involvement in decision-making that binds a legal entity is spread across various countries. Having decision-making taking place in various countries leads to an increased risk of discussions on the presence of PEs, an increased risk of discussions on the attribution of profits to permanent establishments, and the potential obligation to file (multiple) tax returns in the PE countries.

2.3.3 Consequences

- Tax structuring

In our practice we observe that Action 7 is creating substantial uncertainties for MNEs. We see a trend that being 'in control' is becoming more important for MNEs. Certainty is often considered more important than low taxation. The question arises how MNEs will manage the uncertainties created by Action 7.

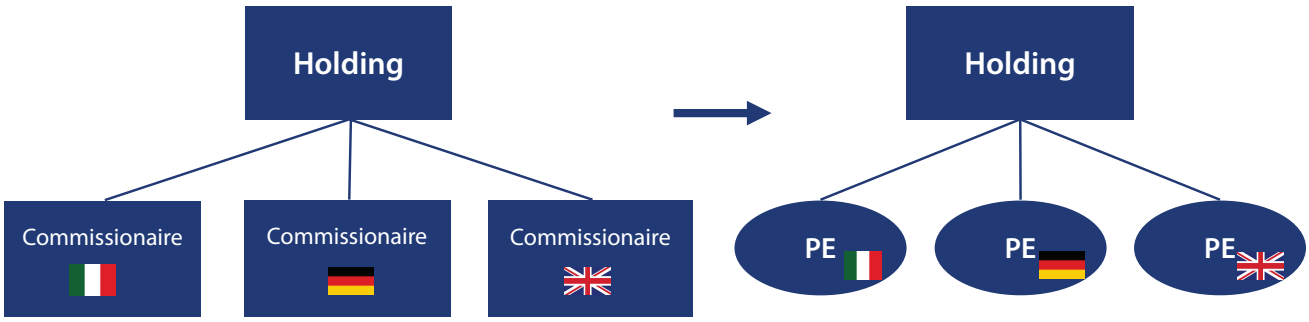
Centralised decision-making in the country where a legal entity is located would decrease the risk created by Action 7. However, this would not be in line with the

49. *See* Action 7 Report, above n. 3, at 9-11.

50. *See* Action 8-10 Reports, above n. 3.

51. *See* OECD, 'Revised discussion draft. BEPS Action 7: Preventing the Artificial Avoidance of PE Status' (2015), available at <www.oecd.org/ctp/treaties/revised-discussion-draft-beps-action-7-pe-status.pdf> (last visited at 20 June 2017), at 37.

52. *See* De Wilde, above n. 12, at Sec. 4.3.



business-driven development of having relevant capabilities for decision-making spread across various locations. Another more likely scenario is that MNEs will avoid discussions with tax authorities by proactively claiming taxable presence in a country. We expect that MNEs will prefer to work with one legal entity with permanent establishments in each country where it formerly operated through a legal entity. This reduces discussions about the presence of PEs of various legal entities, and reduces the taxable presence in each country to one legal entity. As tax practitioners, we also see MNEs considering filing 'zero profit PE filings' in various countries to reduce the risk of fines.

This effect is strengthened when combined with Actions 8-10. Historically, a benefit of using a legal entity instead of a permanent establishment was that for the allocation of profits to a legal entity, the functional analysis takes into account functions performed, assets used and risks assumed. This allows MNEs to influence profit allocation through (contractual) allocation of assets and risks. For the profit allocation to PEs, the OECD states that there is no single part of the enterprise that legally owns assets and assumes risk.[53] As a solution, assets and risks are allocated to that part of the enterprise that performs the *significant people functions* related to the asset/risk.[54] As explained in Section 2.2.1, Actions 8-10 claim that also for legal entities, contractual relationships should be considered in view of functions performed. The difference between profit allocation to legal entities and that to PEs has therefore – at least according to the OECD – substantially been reduced. This contributes to the expected tendency of moving towards PE structures.

- Tax advisory

For tax advisers we expect an important role in assisting MNEs to be in control. In our observations as tax practitioners, to be in control in an uncertain tax environment does not necessarily require certainty on all tax positions taken, but does require full insight and transparent communication about the risks involved for the positions taken and the alternatives, and documented reasons for accepting the risks. We refer to Section 3.3 for guidance on creating awareness of MNEs' attitude towards tax planning.

2.4 BEPS Action 13

2.4.1 New Documentation Requirements

Another part of the BEPS Action Plan we expect to have a big impact is Action 13.[55] Action 13 contains a revised Chapter V of the OECD Guidelines dealing with transfer pricing documentation.[56] The revised guidance requires MNEs to provide tax authorities with high-level information regarding their global business operations and transfer pricing policies in a Master File. In addition, it requires that detailed transactional transfer pricing documentation is provided in a Local File specific to each country, identifying material-related party transactions, the amounts involved in those transactions and the company's analysis of the transfer pricing determinations they have made with regard to those transactions. Very large MNEs are further required to file a Country-by-Country Report that will provide for each tax jurisdiction in which they do business the amount of revenue, profit before income tax, income tax paid and accrued, number of employees, stated capital, retained earnings and tangible assets.[57]

The OECD distinguishes three objectives of the new transfer pricing documentation:[58]

1. To ensure taxpayers give appropriate consideration to transfer pricing requirements.
2. To provide tax administrations with the information needed to conduct a transfer pricing assessment.
3. To provide tax administrations with useful information to employ in conducting an audit of the transfer pricing practices of taxpayers.

These objectives form a logical part of the OECDs efforts to combat BEPS. Tax authorities need information on the transfer pricing system of an MNE to identi-

53. OECD, *Report on the attribution of profits to permanent establishments* (2010), available at <www.oecd.org/ctp/transfer-pricing/45689524.pdf> (last visited 20 June 2017), at 14.
54. Lacking agreements between a head office and a PE, only functions remain. We would like to note that this may not be true for entities with legal personality that qualify as a PE because they are treated as transparent entities for tax purposes.
55. *See* Action 13 Report, above n. 3. Within the EU the outcomes of Action 13 have been implemented on an EU wide basis by means of amending the Administrative Cooperation Directive; *see* Council Directive (EU) 2016/881 of 25 May 2016 amending Directive 2011/16/EU as regards mandatory, automatic exchange of information in the field of taxation, OJ L 146.
56. *See* Action 13 Report, above n. 3, at 11-69.
57. *See* Action 13 Report, above n. 3, at 9.
58. *Ibid.*, at 12-4.

fy where the MNE may have an incentive to optimise the transfer prices used.[59]

2.4.2 Most Important Observations in Relation to Action 13

Action 13 puts a substantial administrative burden on MNEs.[60] In our view, the information that needs to be included in the Master File and Country-by-Country report is in principle available within each MNE.[61] For example, the Master File should include a description of the MNE's important drivers of business profits, the supply chain of the five largest products by turnover and how the MNE is financed.[62] The same applies to the Country-by-Country report, which requires mainly financial input such as revenues, income tax paid and stated capital. To accommodate the complaints of MNEs, the documentation obligations have built in a certain flexibility for taxpayers to choose which information will be included in the documentation. For example, the Country-by-Country report can be based on data from consolidation reporting packages, statutory financial statements, regulatory financial statements or internal management accounts, as long as the choice is made consistently. The guidance on the Master File states that taxpayers should use prudent business judgement in determining the appropriate level of detail for the information supplied, which also gives certain freedom to MNEs.

Although the OECD made some efforts to reduce the administrative burden for MNEs,[63] the administrative burden could in our view have been reduced more by better guidance.

- FTEs

In the Country-by-Country report, there are ambiguous terms that make the completion of the report difficult. There are also requirements to include information that is not available. For example, an MNE should report the total number of employees on a full-time basis. There are MNEs whose accounting software only show the total number of employees, not the full-time equivalent. FTE is equal to (a) the number of total scheduled person hours divided by (b) the number of hours per week of a full-time employee. The number of hours per week of a full-time employee differs between countries (e.g. India 48 hours, the Netherlands 40 hours). No further guidance is provided on how to interpret the term FTE.

- Joint Ventures

More practical problems arise where the taxpayer is a joint venture that is included in the consolidation of one of the joint venture partners.[64] Action 13 would in such case require that the joint venture company keeps a copy of the Master File in its administration, even though it may contain classified information that the joint venture partner may not avail of.

- Interpretation of the term 'products'

Another example is that the Master File should contain a description of the supply chain for the MNE's five largest products or service offerings.[65] There is no explanation as to what the word 'product' means. A simple example. Are the iPhone 6 and the iPhone 7 different products? Is an iPhone 7 with 128GB a different product that the one with 256GB? The guidance gives MNEs the right to use prudent business judgement in determining the appropriate level of detail for the information supplied, which gives some flexibility. Nonetheless, MNEs may be faced with different requirements in different countries. Where certain countries may only accept the Master File if choice A is made, other countries may only accept choice B.

2.4.3 Consequences

(i) Tax structuring

<u>Contribution to identify tax avoidance and aggressive tax planning</u>

We expect that the documentation requirements of Action 13 will form a large contribution to the ability of tax authorities to identify tax avoidance and aggressive tax planning. With more insight into tax structures, tax authorities will be able to more efficiently identify and challenge abuse.

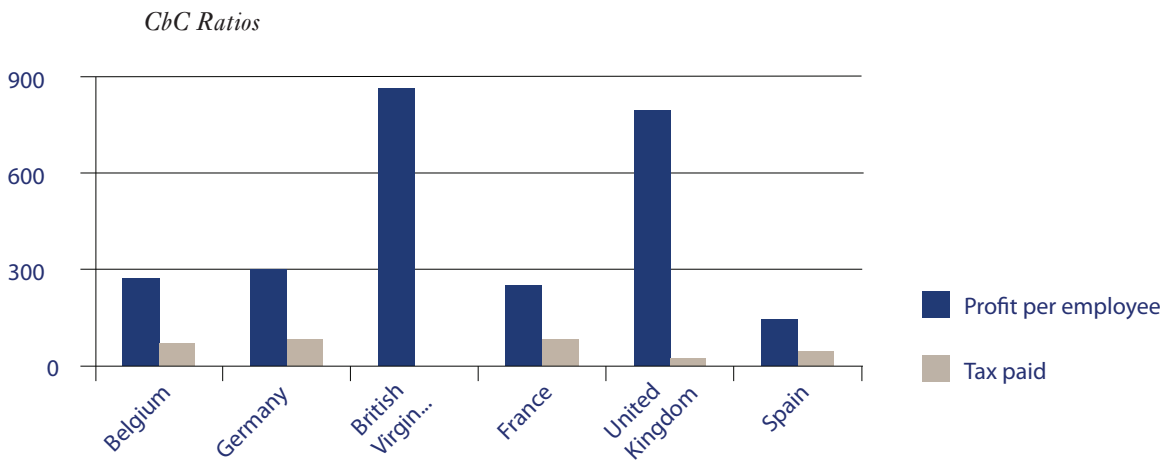
From the Country-by-Country report, tax authorities will be able to gain insight into the division of profits between countries, the taxation of these profits and the ratios that they deem relevant to assess the justification of the division of profits (see graph on next page).

With the Master File and Local File to complement the Country-by-Country data, tax authorities will be able to quickly verify whether the local entities of the MNE entered into transactions with the 'suspicious' jurisdictions.

<u>Conformism: More pressure to act in accordance with 'expectations' of tax authorities</u>[66]

With the knowledge that tax administrations worldwide will have an insight into the division and taxation of profits within the MNE, we believe MNEs will be encouraged to more than ever ensure that its tax structures are in line not only with all applicable tax legislation, but also with the expectations of the tax authorities. In addition, MNEs are encouraged to have transfer pricing documentation available that not only meets the

59. *Ibid.*, at 12.
60. *See e.g.* A.M. Parker, 'BEPS 'Master File' Requirements Raising Concern' (2016), available at <www.bna.com/beps-master-file-m57982059329/> (last visited 20 June 2016).
61. This might be different for the Local File where a benchmark seems to be required for each material controlled transaction.
62. *See* Action 13 Report, above n. 3, at 25.
63. *Ibid.*, at 38 for an example.
64. *See also* OECD, 'Public comments received Volume III. Discussion Draft on Transfer Pricing Documentation and CbC Reporting' (2014), available at <www.oecd.org/ctp/transfer-pricing/volume3.pdf> (last visited at 20 June 2017), at 16.
65. *See* Action 13 Report, above n. 3, at Annex I.
66. *See also* para. 3.3.



bare minimum legal requirements, but that also answers questions that tax authorities are expected to have when reviewing the documentation.

Another potential benefit of the increased transparency is that not only MNEs will be encouraged to improve their behaviour, also jurisdictions themselves may change their policy. Countries often coming up as a 'suspicious' jurisdiction in Country-by-Country reports may – under peer pressure – decide to change legislation to give a better picture in Country-by-Country reports.[67]

Conformism: Pressure to work with 'standard' structures

In our experience as tax practitioners, tax authorities are more likely to challenge tax structures that are not set up in accordance with 'standard market practice'. A transfer pricing system that does not fit within the picture of how transfer pricing systems generally work risks being subject to questions of tax authorities. Many MNEs set up a transfer pricing system with one central entrepreneur, while the other entities perform 'routine' activities (e.g. contract manufacturers and limited risk distributors). MNEs who do not fit within this 'template', for example MNEs who give a high level of independence to local entities, are more likely to be subject to questions of tax authorities when presented with their transfer pricing documentation.[68]

(ii) Tax advisory

Substantial administrative burden and more compliance work

The expected preference of MNEs to have thorough transfer pricing documentation combined with the fact that the legal requirements are far from clear, puts a substantial administrative burden on MNEs and forces them to either set up internal specialised transfer pricing documentation teams or to hire specialised tax advisors to assist in preparing the transfer pricing documentation, meaning more compliance work for tax advisers, and red tape for MNEs.

Accepting 'incorrect' audit adjustments

In our observations as tax practitioners, currently many companies accept 'incorrect' audit adjustments as the risks and costs of challenging the adjustments through litigation and/or mutual agreement or arbitration proceedings simply are too high.[69] These companies often don't seek a corresponding adjustment in other countries to avoid endangering the consistent application of a transfer pricing system. If all information is shared between tax authorities, audit adjustments that deviate from the transfer pricing system consistently applied by an MNE might reduce the chances of 'smooth' dispute resolution in other countries.

3 Three Issues the Anti-BEPS Measures Don't Address

3.1 The Fundamental Problem of the Current Corporate Taxation System

Apple's effective tax rate on the profits realised by its Irish subsidiary Apple Sales International was allegedly 1% in 2003 and 0.005% in 2014.[70] In the UK, Google paid 'just' £6m tax in 2011 on a turnover of £395m.[71]

67. The OECD blacklist lists non-cooperative jurisdictions, and most jurisdictions on the black list have formally enacted regulatory measures. *See* for an analysis on the effectiveness of the blacklist D. Masciandaro, 'Combating Black Money: Money Laundering and Terrorism Finance, International Cooperation and the G8 Role' (2004), *Economics Working paper* No. 56/26, available at <http://dx.doi.org/10.2139/ssrn.561183> (last visited 20 June 2017), at 3. In addition, the EU Council agreed on the establishment of an EU list of third country non-cooperative jurisdictions and to explore coordinated defensive measures at EU level.
68. *See e.g.* European Commission, above n. 6. In this press release the following was said, which can lead to arbitrary taxation: 'In fact, the tax treatment in Ireland enabled Apple to avoid taxation on almost all profits generated by sales of Apple products in the entire EU Single Market. This is due to Apple's decision to record all sales in Ireland rather than in the countries where the products were sold. This structure is however outside the remit of EU state aid control. If other countries were to require Apple to pay more tax on profits of the two companies over the same period under their national taxation rules, this would reduce the amount to be recovered by Ireland.'
69. *See e.g.* Proposal for a Council Directive of 23 May 2017 on Tax Dispute Resolution Mechanisms in the European Union, 9420/17. However, these procedures can still take several years.
70. European Commission, above n. 6.
71. BBC, 'Google, Amazon, Starbucks: The Rise of Tax Shaming' (2013), available at <www.bbc.com/news/magazine-20560359> (last visited at 20 June 2017).

For the public, these numbers at the least raise the question how effective the corporation tax system (in Europe) is. Politicians perceive it as easy to – within one MNE – shift profits to low-tax jurisdictions – either by transferring 'real activities' (i.e. functions) or merely ownership of assets and risks – and/or to 'erode' the tax base with deductible royalty or interest payments.[72]

The question arises is whether the BEPS measures are the best way to improve fairness in international taxation. Instead of implementing the BEPS measures, De Wilde, for instance, advocates a more fundamental reconsideration of the sustainability of the tax system as a whole.[73] In his recent thesis on the existing model of international corporate taxation, he states:

> The current model of corporate taxation finds its origins in the 1920s. It well suited the economic realities of the early days of international trade and commerce; the times when international business primarily revolved around bulk trade and bricks-and-mortar industries. But those days are long gone. Globalisation, European integration, the rise of multinational enterprises, e-commerce, and intangible assets have changed the world considerably.
>
> These developments have caused the model to operate inconsistently with the economic reality of today. Corporate taxation and economic reality are no longer aligned. The model is ill-suited to current market realities. As a result multinational business decisions are distorted by tax considerations. The arbitrage may work to the benefit or detriment of nationally and internationally active firms. It also seems to put pressure on nation state corporate tax revenue levels. This may lead to spill-over effects and welfare losses at the end of the day. Matters seem to worsen in today's increasingly globalizing economy.[74]

> …corporate entities are typically subject to corporation tax on an individual basis under the separate entity approach. This approach is generally upheld in the event that these taxable entities belong to an integrated group. However, in reality multinational groups of companies do not operate in a segregated manner. They operate in concert as a functionally integrated economic entity with a common objective of profit-optimisation.[75]

The core problem is that Actions 8-10 maintain the separate entity approach, in which each entity of an MNE is taxed separately, instead of taxing the MNE as a whole.[76]

Historically, each legal entity in an MNE generally had local capabilities for decision-making relevant for that entity. We see a development of having relevant capabilities for decision-making spread across various locations. For efficiency reasons, there is trend that not all relevant capabilities to make business decisions are present in each separate affiliate. Instead, legal entities use capabilities available elsewhere in the group to assist in decision-making.[77] This process is facilitated by a globalising world that offers flexibility in where people perform their functions (e.g. videoconference, the cloud, regular traveling, etc.). For example sales entities don't need local experts anymore for functions other than sales (like accounting, corporate governance, finance, etc.). These functions are performed at one or more other locations. As another example, it is often difficult to find qualified people to form the board. In addition, the 'responsible people' for a specific task within an MNE change rapidly, often also to different countries. The highest ranked European marketing manager might be located in a different country than his predecessor. As a result, we more and more see that involvement in decision-making that binds a legal entity is spread across various countries.

We see that an MNE is often artificially dividend into individual entities to meet local law requirements. Therefore, taxing legal entities instead of MNEs does no longer fit within current business reality.

Actions 8-10 do not address the fundamental problems underlying the tax system, but instead try to 'fix' alleged abuses that are caused by the system, by proposing 'solutions' that still don't fit within the reality of the current international business practice.

"*Basically all tax jurisdictions attempt to geographically localise business activities and the business income produced. The purpose is to ensure that business income generated within the territory of the taxing state is taxed by that state*."[78] As noted above, the political perception is that taxation of multinational enterprises is not aligned with the economic activity that produces their profits (i.e. not aligned with 'value creation'). The perception is that value creation is for the main part attributable to sales and to employees. Actions 8-10 and Action 7 try to address this issue.[79] Actions 8-10 seem to claim that under the arm's length principle, functions (i.e. employees) determine where profits should be allocated. Action 7 tries to align taxation with sales by creating taxable presence of foreign legal entities in the country where the sales (or other decisions) are made.

72. *See e.g.* C.E. McLure, Jr., 'The State Corporate Income Tax: Lambs in Wolves' Clothing', in H.J. Aaron et al. (eds.), *The Economics of Taxation* (1980) at 327.
73. Alternative systems have been advocated by many and proposals range from formulary systems to destination based cash flow taxation systems. *See* for overviews and assessments De Wilde (2015), above n. 12, at Chapters 5 and 6.
74. *See* De Wilde (2015), above n. 12, at Preface.
75. *Ibid.*, at Sec. 1.1.4.3.
76. *See* for a comparison M. Kobetsky, 'The Case for Unitary Taxation of International Enterprises', 62 *Bulletin for International Taxation* 201 (2008). Kobetsky argues essentially that taxing highly integrated international enterprises (*e.g.* banks) on a unitary basis is appropriate because these businesses operate on a unitary basis.
77. *See* for a comparison K. Sadiq, 'Unitary Taxation: The Case for Global Formulary Apportionment', 55 *Bulletin for International Taxation* no. 7 (2001), at 275-86.
78. De Wilde (2015), above n. 12, at 164.
79. *See* Action Report 7, above n. 3, and Action Reports 8-10, above n. 3.

But value creation is not necessarily attributable to sales and employees. Empirical research even shows that labour should play little if any role in allocating taxing rights; any causality link between labour costs and profit-making seems absent.[80] Identifying where value is generated is a fundamental problem of conventional corporation taxes in an international setting.[81] Value creation is an economic question, the result of supply and demand in the market. Economics is the study of how people choose to allocate their scarce resources.[82] The price for each resource that contributes to the profit is determined by demand and supply.[83] Capital and IP might be scarce resources 'creating value'.[84] In addition to looking at this 'supply side' of profit generation, the demand side (revenue) should be considered.[85]

By maintaining the traditional transfer pricing question of which economic activities create which profits, the OECD continues supporting substantial profit attribution to mobile production factors such as capital and IP, which can relatively easily be shifted legally to tax friendly locations. If the OECD wanted to tax profits based on sales and employees, it should step away from the traditional transfer pricing question of which economic activities create which profits, and instead impose a tax based on the factors sales and employees.

3.2 Corporation Tax Is among the Most Distorting Taxes

At the time that MNEs paid low taxes in the countries where their products were sold (for high prices), citizens faced economic recession and governments faced high deficits after the economic crisis that started in 2008.[86] In this light it is understandable that governments may be attracted to tax corporate profits. Voters generally perceive such taxes as being borne by companies or their wealthy owners and see it as a 'justified' way to increase tax revenues without hurting the public. With the public opinion on tax avoidance in mind, it was a small step for governments to try to increase tax revenue by combatting BEPS.

However, the tendency towards levying corporation tax might be unjustified. As noted by the Mirrlees review in 2011, 'perhaps the most important point to keep in mind when considering company taxation is that it is not meaningful to think about the effects of taxes on companies separately from the effects of those taxes on the individuals associated with companies' (such as the owners, employees, customers, etc.).[87] Imposing a tax that is statutory borne by companies does not automatically mean that the economic burden of such tax is also borne by those companies (or its shareholders).[88] Through product pricing and wages, it could very well be borne by the customers or employees of the company.

Who eventually bears the 'effective incidence' of a corporation tax is difficult, if not impossible, to predict. It depends on 'the form of the corporate tax, the nature of the economy in which it is levied, and the choices open to the firms on which it is imposed'.[89] But some direction can be given, it seems at least. Recent empirical studies have demonstrated that an increase of corporation tax is to a large extent borne by the workforce through lower wages.[90]

In addition, corporation taxes are considered to be among the most distorting taxes.[91] Taken into account this observation and the expectation that corporation taxes are in the end to a large extent borne by the workforce, it could very well be that employees would be better off if their wages or expenses would be taxed directly.[92]

3.3 The Responsibility of Paying a 'Fair Share'

In international taxation, the responsibility to determine which country may tax which profits when MNEs do business in more than one country is laid in the hands of MNEs. This has been done by continuing with the arm's length principle (Article 9 of the OECD Model Convention). Any alternative would increase the risk of double taxation or would require an alternative allocation system. Apparently, early in the BEPS discussions the participating countries have not been able to agree on how to divide income from taxation on worldwide profits themselves in an alternative way, for example by treating an MNE as one taxpayer that pays taxes on its worldwide income in one country.[93] This country then divides the tax income between all countries in which the MNE is active. Such a solution requires international tax coordination of an unprecedented level, and a willingness of countries to give up their sovereignty in

80. J.R. Hines Jr., 'Income Misattribution under Formula Apportionment', 54 *European Economic Review* 108 (2010).
81. M.P. Devereux, 'Taxation of Outbound Direct Investment: Economic Principles and Tax Policy Considerations', 24 *Oxford Review of Economic Policy* 698 (2008), at 25.
82. W.J. Wessels, *Economics* (2000), at 2.
83. Musgrave, above n. 7.
84. M. Markham, *The Transfer Pricing of Intangibles* (2005).
85. *See* for a comparison Musgrave, above n. 7, at 228-46.
86. For in-depth analyses of developments in the build-up period to the launch of the BEPS initiative by G20 and OECD *see* R.S. Avi-Yonah, 'Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State', 113 *Harvard Law Review* 1573 (2000), at 1573-1676.
87. J. Mirrlees *et al.*, 'Tax by Design' (2011), available at <www.ifs.org.uk/publications/5353> (last visited 20 June 2017) at 408.
88. *See* W. Vermeend *et al.*, Taxes and the Economy; a Survey on the Impact of Taxes on Growth, Employment, Investment, Consumption and the Environment (2008), at 41 and 156.
89. *Ibid.*, at 409.
90. W. Arulampalam, M. Devereux & G. Maffini, 'The Direct Incidence of Corporate Income Taxes on Wages' (2012), 56 *European Economic Review* 6, at 1038-54.
91. OECD, 2008, Taxation and Economic Growth.
92. J. Mirrlees *et al.*, above n. 87, at 411.
93. Worth noting is that this meets the observations of the US state tax authorities close to a century ago: 'there is no right rule of apportionment (…) the only right rule (…) is a rule on which the several states can and will get together as a matter of comity'. *See* C.S. Lamb *et al.*, 'Report of Committee on the Apportionment between States of Taxes on Mercantile and Manufacturing Business' (1922), 15 *National Tax Association*, 198-212, at 202.

Orientation	Source	Considerations	Central question
Egoism	Own interest	Profits	What helps me most?
Legalism	Law and rules	Fines, court cases	What does the law require?
Conformism	Expectations of others	Reputation, acceptation	What do other expect from?
Ethical	Balanced interest	Conscious and general interest	What is best for all stakeholders?
Altruism	Interest of others	Sacrifice	What helps others most?

taxation (like the CCCTB).[94] More importantly, this requires countries to make a division of profits with which they all agree. Countries have not been able to come to such an agreement and made MNEs responsible to divide profits between countries. May it be expected from an MNE that it divides profits in such a way that all countries are 'happy' with their share?[95]

The responsibility to divide profits gives MNEs the freedom to arrange their transfer pricing in such a way that total taxation is lowest, while they still comply with local legislation in each country. The question arises whether – besides a legal obligation to pay tax – there is also a 'moral obligation' to pay tax if the law allows to reduce taxation to a minimum. In this regard, the observation of the US Judge Learned Hand is famous:

> Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes.[96] Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands: taxes are enforced exactions, not voluntary contributions. To demand more in the name of morals is mere cant.[97]

Following this conclusion, countries cannot rely on the moral duty of MNEs to pay more tax than required by law. In our view, MNEs may voluntarily pay more taxes than law requires, but may also take on a different attitude. The attitudes towards taxation can be distinguished as in the table above.[98]

In view of the observation of the US Judge Learned Hand stated above,[99] MNEs may in our view choose any attitude with a minimum of legalism. In our observations as tax practitioners, we see a shift from legalism to conformism. Legalism and to a lesser extent conformism allow for tax optimisation. If countries do not want to run the risk that certain profits remain low taxed, they should divide the profits themselves. With the choice of making tax payers responsible for dividing profits, countries shifted the risk of double taxation to tax payers, but also the risk of double non-taxation. For the future of tax advisory, we see an important role for tax advisers to create awareness of the potential attitudes and to match the tax advice that is given to clients to the selected attitude. The role of tax advisory shifts from advising MNEs on the lowest possible effective tax rate to a broader advise including risks, risk appetite and public expectations.

4 Conclusions

Politics perceives taxation of MNEs as not aligned with the economic activity that produces their profits (i.e. not aligned with 'value creation'). In this perception, value creation is for the main part attributable to sales and to employees. But value creation is not necessarily attributable to sales and employees. Value creation is an economic question, the result of supply and demand in the market. In BEPS Actions 8-10, the OECD maintains the traditional transfer pricing question of which economic activities create which profits. Thereby, the OECD keeps the risk alive that substantial profits are attributable to mobile scarce production factors such as capital, which can relatively easily be shifted to tax friendly locations. If the OECD wanted to tax profits

94. On 25 October 2016, as part of a broader package of corporate tax reforms (*see* European Commission, 'Corporate Tax Reform Package' (2016), available at <https://ec.europa.eu/taxation_customs/business/company-tax/corporate-tax-reform-package_en_en> (last visited 20 June 2017)), the European Commission released proposals for a so-called CC(C)TB, relaunching its original CCCTB proposal of 16 March 2011 in two stages, essentially with a view to introducing unitary taxation and formulary apportionment in the internal market; *see* Proposal for a Council Directive on a Common Corporate Tax Base (CCTB) of 25 October 2016, 2016/0337; Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) of 25 October 2016, 2016/0336; *and see* Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (CCCTB) of 16 March 2011, 2011/0058.
95. The Commission proposals for introducing a CCCTB for instance have already met some fierce resistance by a number of EU Member States and some have raised formal objections against the proposals; *see* for an overview EUR, 'Procedure 2016/0336/CNNS' (2016), available at <http://eur-lex.europa.eu/legal-content/ENG/HIS/?uri=COM:2016:683:FINforanoverview> (last visited 20 June 2017).
96. U.S. Court of Appeals for the Second Circuit, *Helvering* v. *Gregory*, 69 F.2d 809 (1934).
97. U.S. Court of Appeals for the Second Circuit, *Commissioner of Internal Revenue* v. *Newman*, 159 F.2d 848 (1947).
98. Derived from VNO-NCW and MKB-Nederland, *Leiderschap in ethiek, Inspiratie voor een baanbrekende ethiek voor bedrijven* (2016), at 11, and further applied in the field of taxation by T. Bender, 'Tussen ethiek en wet: een derde weg', *Weekblad Fiscaal Recht* 20 (2017).
99. U.S. Court of Appeals for the Second Circuit, above n. 96.

based on sales and employees, it should step away from the traditional transfer pricing question of which economic activities create which profits, and instead impose a tax based on factors that are less mobile (e.g. sales and employees). As the proposed solution is not fully aligned with the underlying intentions of politicians, many uncertainties arise.

How will this impact tax structuring and tax advisory? We expect the following consequences:

- Actions 8-10 combat existing tax planning opportunities for MNEs, but does so in a way that it creates more disputes with tax authorities, a shift of functions away from high tax countries, a diminishing value of the OECD Transfer Pricing Guidelines and new tax planning opportunities. As such, Actions 8-10 may not be the best way to reduce 'aggressive tax planning'.
- Tax planning will focus more on tax beneficial structures in which the business set-up runs parallel with the tax structure. We expect the use of empty cash boxes (e.g. intellectual property (IP) companies) to reduce, knowing that tax authorities will challenge such structures. The IP will be relocated to locations with the relevant substance to manage the IP, while the arm's length principle, notwithstanding the changes of Actions 8-10, is expected to leave sufficient opportunities to keep the tax benefits.
- Tax advisers need to take a more critical role towards positions taken by tax authorities and not automatically accept their positions as the 'truth'. Some tax authorities will be tempted to argue that more profits should be allocated to them provoked by the ambiguous guidance on how associated enterprises should price their transactions We fear that this will lead to more 'aggressive tax collection' by tax administrations.
- For the future of tax advisory, we see an important role for tax advisers to create awareness of the potential attitudes of clients towards tax structuring and to match the tax advice that is given with the selected attitude. The role of tax advisory shift from advising MNEs on the lowest possible effective tax rate to a broader advise including risks, risk appetite and public expectations.
- MNEs will avoid discussions with tax authorities by proactively claiming taxable presence in a country. In our observations as tax practitioners, from a tax perspective MNEs will prefer working with one legal entity with permanent establishments in each country where it formerly operated through a legal entity, even though there are business reasons to use separate entities. This reduces discussions about the presence of PEs of various legal entities, and reduces the taxable presence in each country to one legal entity.
- Action 13 will contribute to identify tax avoidance and aggressive tax planning, it will put more pressure to act in accordance with 'expectations' of tax authorities and to work with 'standard' structures, it will create a substantial administrative burden and more compliance work, and in our observations as tax practitioners, it will tempt MNEs to accept 'incorrect' audit adjustments to avoid having to deviate from a consistently applied transfer pricing system.