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Tax Competition and Tax Cooperation: A Survey and Reassessment

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International Taxation in a Changing Landscape

Liber Amicorum in Honour of Bertil Wiman

Edited by

Jérôme Monsenego
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Prof. Dr Bertil Wiman

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CHAPTER 1

Tax Competition and Tax Cooperation: A Survey and Reassessment

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§1.01 INTRODUCTION

'The Changing Landscape of International Taxation', the general subject selected for this much deserved Liber Amicorum in honour of Bertil Wiman, could not have been more timely. Bertil has touched on many of the features of that 'landscape' in his writings over the years. However, two issues regarding the changing international tax landscape have dominated discussions over the past two decades and warrant particular attention: tax competition and tax cooperation. In this short piece, I would like to review some of the developments in these areas and look ahead at what might be coming.

To begin, it is important to identify two distinct strands which animate and underlie developments in tax competition and cooperation. Since 1998 much of the focus has been on tax competition among countries to attract foreign investment and reduce incentives for domestic investment to go abroad. The concerns regarding externalities involved in this potential 'race to the bottom' have generated a number of institutional arrangements and structures to promote tax cooperation and prevent tax avoidance. Somewhat less noticed until recently, there has also been a second and more historically rooted aspect of tax competition. Countries compete for tax revenues and claims for taxing jurisdiction to generate the means to support the basic needs of the state. This latter aspect of tax competition goes back to the oft-cited work of the League of Nations and the subsequent development of coordinated rules for assigning taxing claims and the responsibility for relieving double taxation. Currently, however, this aspect of tax competition has attracted more attention as countries attempt to adapt their tax structures to deal with the challenges posed by the 'digitalisation' of the economy. It remains to be seen, however, whether the institutional structures and

arrangements developed primarily for dealing with tax coordination in the context of attracting investment will be sufficient to handle the new issues raised by the latest round of revenue competition.

§1.02 COMPETITION FOR INVESTMENT

[A] The 1998 Tax Competition Report

Beginning in the late 1990s, the issue of tax competition for investment became the focus of work at the G-7 and the Organisation for Economic Co-operation and Development (OECD). This work culminated in the 1998 publication of a Report entitled *Harmful Tax Competition: An Emerging Global Issue*.[1] The scope of the Report was limited; it dealt only with 'geographically mobile activities' such as offshore banking, headquarters and services companies and the like. In addition, as the title suggests, the Report tries to distinguish between 'harmful' and 'acceptable' forms of tax competition even with respect to these activities. In determining whether a particular measure constituted a 'harmful preferential regime' and hence harmful tax competition, the Report focused principally on four factors:

(1) **No or low effective tax rates:** A low or zero effective tax rate on the relevant income is a necessary starting point for an examination of whether a preferential tax regime is harmful. A zero or low effective tax rate may arise because the schedule headline rate itself is very low or because of the way in which a country defines the tax base to which the rate is applied. A harmful preferential tax regime will be characterised by a combination of a low or zero effective tax rate and one or more other factors [*described below*].

(2) **'Ring-fencing' of regimes**: Some preferential tax regimes are partly or fully insulated from the domestic markets of the country providing the regime. The fact that a country feels the need to protect its own economy from the regime by ring-fencing provides a strong indication that a regime has the potential to create harmful spillover effects. Ring-fencing may take a number of forms, including: a regime may explicitly or implicitly exclude resident taxpayers from taking advantage of its benefits; enterprises which benefit from the regime may be explicitly or implicitly prohibited from operating in the domestic market.

(3) **Lack of transparency:** The lack of transparency in the operation of a regime will make it harder for the home country to take defensive measures. Non-transparency may arise from the way in which a regime is designed and administered. Non-transparency is a broad concept that includes, among others, favourable application of laws and regulations, negotiable tax provisions and a failure to make widely available administrative practices.

1. *Harmful Tax Competition: An Emerging Global Issue* (OECD, 1998) ('1998 Report').

(4) **Lack of effective exchange of information:** The lack of effective exchange of information in relation to taxpayers benefiting from the operation of a preferential tax regime is a strong indication that a country is engaging in harmful tax competition.[2]

A number of 'other' factors such as an artificial definition of the tax base, the failure to tax foreign source income and access to a wide treaty network were also considered but the four-factor analysis was at the heart of the Report. From an analytical point of view, the most important aspect of the Report was the position that low tax rates *by themselves* did not constitute inappropriate tax competition for investment: the low rates had to be accompanied by other factors. As the Report stated:

> The Committee recognises that there are no particular reasons why any two countries should have the same level and structure of taxation. Although differences in tax levels and structures may have implications for other countries, these are essentially political decisions for national governments. Depending on the decisions taken, levels of tax may be high or low relative to other states and the composition of the tax burden may vary. The fact that a country has modernised its fiscal infrastructure earlier than other countries, for example by lowering the rates and broadening the base to promote greater neutrality, is principally a matter of domestic policy. Countries should remain free to design their own tax systems as long as they abide by internationally accepted standards in doing so. This study is designed, in part, to assist in that regard.[3]

As a consequence of the analysis in the Report, countries that were willing to accept a low generally applicable rate to all forms of investment, domestic or foreign-owned would not be viewed as engaging in 'harmful' tax competition for investment. Thus Ireland, much criticised earlier for its 'Dublin Docks' ring-fenced regimes, was able to eliminate those restricted regimes and adopt a general 12.5% rate and avoid 'harmful' classification. This approach to attracting business investment was not open to larger economies which could not absorb the accompanying revenue loss on purely domestic activities.

The Report also set up an institutional structure to examine regimes, that is the Forum on Harmful Tax Practices (FHTP) discussed below in section §1.03[B].

[B] Base Erosion and Profit Shifting

The OECD Base Erosion and Profit Shifting (BEPS) project was not explicitly focused on tax competition to keep or retain investment. Rather it was principally concerned with 'lack of coherence' in international rules leading to instances of 'double non-taxation' and situations where the mechanical application of rules assigning taxing jurisdiction results in profits being effectively shifted to low or no-tax jurisdictions.[4] Nonetheless, there were some aspects of the BEPS work which relate to competition for investment.

2. *1998 Report* 27.
3. *Id*. 15.
4. *Action Plan on Base Erosion and Profit Shifting* (OECD, 2013) 13.

Most directly, Action 5 dealing with 'harmful tax practices' discussed below in section §1.02[C] expands and amplifies the work outlined in the 1998 Report. But there are other aspects of BEPS which can be viewed as restricting competition for investment.

For example, the BEPS restrictions on interest stripping are related to countries which allowed foreign investors to in effect create a preferential rate of tax on inward investment through base erosion. Similarly, the limitations on hybrid financing arrangements prevent the creation of deductible-nontaxable payment streams which could be viewed as encouraging the location of financing companies. Restrictions on the use of hybrid entities (in particular, United States check-the-box strategies) can be viewed as a mechanism to prevent the reduction of the effective tax rate on offshore investments by domestic 'national champions'. Requiring treaty modifications to prevent treaty shopping can be viewed as imposing limitations on countries which assisted in treaty shopping by encouraging holding companies without substance. In addition, the requirements that income allocated under the domestic transfer pricing rules have some connection with the 'value creation' in that jurisdiction, already mentioned as an 'other' factor in the 1998 Report, are substantially tightened.

[C] The Case of Patent Boxes

BEPS Action 5 is focused on 'countering harmful tax practices more effectively' and builds explicitly on the work of the 1998 Report.[5] It expands the information exchange obligations which were an important part of the 1998 Recommendations by requiring that countries exchange rulings which are granted with respect to preferential regimes, defined in general by the same focus on characteristics as the 1998 Report. Covered explicitly are financing and patent box regimes, unilateral advance pricing agreements, conduit rules and the like. In this way, the residence country of the taxpayer benefiting from the preferential regime will be able to decide how, if at all, it would be able to tax the underlying income, for example, through its controlled foreign corporation (CFC) rules or by modifying its tax treaties to allow the taxation of such income. Here the impact of the preferential regime in attracting investment can be limited by the country whose base is being eroded if it wishes. This is consistent with the basic thrust of the 1998 Report on the exchange of information as a key to international cooperation.

More important, the BEPS work on preferential regimes adds a new and substantive requirement for regimes which offer a preferential rate of tax on intangible-based income. Those regimes must require that taxpayers claiming beneficial treatment under the regime carry on 'substantial activities' in the country offering the regime. Directly incurred expenditures for research and development incurred by the taxpayer are used as a kind of proxy for measuring activity.[6] This restriction will have the effect of limiting 'treaty shopping' strategies that seek to artificially route income through a patent box jurisdiction.

5. *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report* (OECD, 2015) 15.
6. *Id.* 23.

§1.03 INSTITUTIONAL MECHANISMS TO FACILITATE COOPERATION

In the period between the publication of the Harmful Tax Competition Report in 1998 and the adoption of the BEPS Action plan in 2013, there has been a striking increase in the mechanisms and institutions through which countries can cooperate. While these institutions have varying goals, achieving both agreement with respect to appropriate limitations on a country's ability to attract investment and mechanisms to implement those agreements have played an important role.

[A] Forum on Harmful Tax Practices

The 1998 Report provided for the establishment of a separate body, the Forum on Harmful Tax Practices operating under the OECD Committee on Fiscal Affairs (CFA), to oversee the implementation of the standards established by the Report on Harmful Tax Competition. Under the procedures developed by the Forum, countries initially undertook a 'self-review' process under which a country would examine its own potentially harmful regimes and present a summary of the features of the regime to the Forum. The Forum would evaluate the regime and indicate which features were found to be inconsistent with the criteria of the Report, and the countries involved would then be expected to modify the objectionable features of the regime or eliminate the regime altogether. In addition, under the procedures, a country could ask the Forum to evaluate a regime of another country if it was not listed in the self-review. Of the forty-seven regimes initially identified as potentially harmful in 2000, by 2006 all had been either modified or repealed.[7]

The work of the Forum was substantially expanded in connection with the BEPS project and tasked with a peer review of the requirements of Action 5 for the compulsory exchange of rulings involving preferential regimes and the qualification of regimes under the revised criteria which included the requirement of 'substantial activity'. The basic technique adopted for this work involves a peer review of the regime and publication of the conclusions. The conclusions of the Forum are reached under a 'consensus minus one' approach under which a country cannot prevent the publication of an evaluation of its regimes. The work of the Forum is carried out under the auspices of the Inclusive Framework (*see* section §1.03[C] below) and currently involves some 123 countries. A Progress Report published in 2017 indicates that some 164 regimes are in various stages of review and gives a detailed description of the various approaches used in determining compliance with the criteria.[8]

[B] Global Forum on Transparency and Exchange of Information

The Global Forum on Transparency and Exchange of Information had its origins in the 1998 Report's explicit concerns with the ability of tax havens to attract mobile financial

7. *The OECDs Project on Harmful Tax Practices: 2006 Update* (OECD, 2006) 6.
8. *Harmful Tax Practices –2017 Report on Harmful Preferential Regimes* (OECD, 2017) 11.

and services activities by offering bank secrecy and other restrictions on sharing of taxpayer information. The Forum was initially used to induce 'non-cooperative' jurisdictions to 'commit' to provide bank information and enter into agreements for exchange of information. However, in 2009 at the urging of the G20, the activities of the Forum were substantially restructured and expanded. While based in the OECD, its membership is currently open to all jurisdictions who are willing to implement the OECD-developed standards for transparency and exchange of information. The standards involve both the exchange of information on request and automatic exchange of financial account information. The Forum currently has 154 members and has developed an extensive procedure for peer review and monitoring of the extent to which countries involved are complying with the agreed standards. The peer review process involves looking first at a country's legal and regulatory framework and then examining the actual operation of the provisions. Under a kind of 'name and shame' procedure, a report on the status of the country and its progress (or lack of progress) in meeting the standards is made public. In its last report, the Forum indicated that the 94% of the reviewed jurisdictions had been found to be 'compliant', 'largely compliant' or 'provisionally largely compliant', and only a handful 'non-compliant'.[9]

[C] Inclusive Framework

While non-G20/OECD countries were involved to some extent in the development of the various BEPS Action Items, the establishment in 2016 of the G20/OECD Inclusive Framework on BEPS dramatically expanded the scope of the jurisdictions cooperating on international tax matters. As of June 2018, about 116 countries representing 95% of the global economy are represented in the Inclusive Forum.[10] Non-G20/OECD countries, referred to as BEPS Associates, work on an equal footing with the OECD and G20 members on the remaining standard-setting under the BEPS project, as well as the review and monitoring of the implementation of the BEPS package.[11] Note there are several elements in defining the role of the Associates. First, they will be involved in the 'remaining standard-setting' under the BEPS project. This suggests that there will be additional issues related to base erosion and profit shifting which might be considered by the expanded membership. This might include, for example, revisions of the Transfer Pricing Guidelines to review matters like one-sided TNMM determinations or more generally the basis on which income is allocated to the market jurisdiction such as the expanded use of profit splits. In addition, the Inclusive Framework has an important role in the review of the extent to which countries in fact follow the various positions outlined in the Action Items. This parallels the monitoring and review functions already established in the FHTP and the Forum on Transparency and Exchange of Information.

As a condition for joining the Inclusive Framework, however, the Associates must agree to implement the four BEPS items which are classified as 'minimum

9. *Tax Transparency 2017 Report on Progress (OECD, 2017)* 3.
10. *OECD/G-20 Inclusive Framework: Progress Report July 2017–June 2018* (OECD, 2018) 1.
11. *Id.* 6.

standards'. These are Action 5 on harmful tax practices and compulsory exchange of rulings; Action 6 with respect to treaty abuse, including some combination of a principal purpose test or a limitation on benefits article and some kind of domestic anti-conduit rule; Action 13 on Country-by-Country Reporting to enable tax administrations to better assess risks in transfer pricing situations; and Action 14 on dispute resolution. With respect to Action 14, this may require a number of countries to make significant improvements in their mutual agreement procedures. As discussed in section §1.03[A], the review and monitoring procedures have already begun with respect to harmful regimes and progress has also been made on Action Items 13 and 14.[12]

[D] Coordination Through Multilateral Agreements

A number of the matters dealt with in the BEPS Action Items involve obligations which countries are required to fulfil through treaties. To facilitate treaty changes and the implementation of these BEPS treaty recommendations, the BEPS work introduces a new multilateral agreement and increases the significance of an existing one.

[1] Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting

A number of the BEPS recommendations and minimum standards involve the modification of current bilateral tax treaties. For example, Action 6 requires a number of treaty changes to prevent treaty abuse and clarifies that treaties are not intended to facilitate situations of double non-taxation. These changes are part of the 'minimum standards' that countries must meet as a condition to participating in the Inclusive Framework (section §1.03[C]). The implementation of this standard would involve the renegotiation of thousands of bilateral treaties, a complex and lengthy process. Anticipating this problem, Action 15 proposed the development of a 'multilateral instrument' (MLI) to facilitate treaty modification.[13] An ad hoc group of over 100 countries participated in work on the MLI, and an agreed text was released in 2016. Under the basic approach of the MLI, a country party to the instrument would first indicate which existing treaties it wanted to modify under the MLI ('covered tax agreements') and then indicate which of the substantive provisions of the MLI it wanted to apply. The MLI does not operate as protocol to the existing treaties. Rather, the MLI sits alongside the existing treaty which must then be interpreted in light of the substantive provisions in the MLI. Treaty-related 'minimum standards' which are required as a condition to participating in the Inclusive Framework (*see* section §1.03[C]) must be included in the provisions covered by the MLI. Thus the BEPS provisions dealing with tax treaty abuse and improvement of the dispute resolution

12. *Id.* 8.
13. *Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS* (OECD, 2015).

process (MAPs) must be included. Sixty-seven countries have signed the MLI, and as of June 2017, over 1,000 agreements had been 'matched'.[14]

[2] Convention for the Mutual Administrative Assistance in Tax Matters

The Convention was initially developed jointly by the OECD and the Council of Europe in 1988.[15] It provides a coordinated approach to various matters concerning the assessment and collection of taxes by the participating jurisdictions. It supplements the administrative provisions in bilateral tax treaties, for example, by adding a provision for collection of taxes. After its initial introduction, the Convention was not much used but after calls by the G20 in 2009 to use the Convention to help develop an international standard on exchange of information (*see* section §1.03[B] above) it was amended in 2010 and opened to all countries for signature. There are currently 126 countries involved in various stages of the adoption of the Convention.[16] The amended Convention was the legal basis for the development of a multilateral competent authority agreement to facilitate the exchange of country-by-country reports as envisioned by Action Item 13. In addition, a second multilateral competent authority agreement has been developed under the Convention to assist countries in complying with the requirements of the Common Reporting Standard for exchanging financial account information.

§1.04 COMPETITION FOR REVENUE

Much prior to the developments with respect to tax competition for investment, countries were faced with the issue of tax competition for revenues and the resulting problem of potential double taxation as countries asserted their taxing claims in an uncoordinated way. As has been recounted innumerable times, the response to these issues has been the development of the by now familiar and (nearly) universally accepted rules, both in treaties and in domestic law, regarding residence and source taxation. The source country is given the primary right to tax certain classes of income, while the residence country can assert a worldwide claim but has an obligation to relieve the potential double taxation which might arise. While the various iterations of these rules differ significantly in their details, the basic structure of the rules is well established. And most important, the BEPS project is quite explicit that its aim is not to disturb the basic allocations of current practices:

> While actions to address BEPS will restore both source and residence taxation in a number of cases where cross-border income would otherwise go untaxed or would

14. *See* MLI Q&A, http://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm (accessed 14 Nov. 2018).
15. Convention for the Mutual Administrative Assistance in Tax Matters amended by the 2010 Protocols (OECD, 2010) 1.
16. Convention on Mutual Assistance in Tax Matters, http://www.oecd.org/ctp/exchange-of-tax-information/convention-on-mutual-administrative-assistance-in-tax-matters.htm (accessed 14 Nov. 2018).

be taxed at very low rates, these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income.[17]

However, several matters have brought these issues again into focus.

[A] Minimum Rates

The one area that the various restrictions on tax competition for investment left open for countries to pursue was a general reduction in corporate tax rates. And this is a pattern which has been almost universally followed, with an increasing concern about the revenue-raising capabilities of the corporate tax. In a sense, the 1998 Report (and following developments) was the victim of its own success; harmful tax regimes have been eliminated, but the acceptance of tax competition with respect to rates has continued unabated. The corresponding potential decrease in corporate tax revenues has led some countries to call for agreement on some form of minimum corporate tax rate, an approach explicitly rejected in 1998. German and France have recently proposed cooperation on the introduction of minimum corporate rates to the G-7.[18] More important, however, is the question of the allocation of taxing rights with respect to the digital economy which takes us back to tax competition for revenues and the sustainability of the historical consensus.

[B] Taxing the Global Economy

The one area in the BEPS project which deals explicitly with tax competition for revenues is Action 1, 'Address the challenges of the Global Economy'. Some of the aspects of allocating taxing rights with regard to income arising from digitalised activity are dealt with in other Action Items. For example, Action 7 limits the ability to 'artificially' avoid permanent establishment status and Action Items 8-10 modify the Transfer Pricing Guidelines to make clear that mere legal ownership of intangibles in a jurisdiction does not justify an allocation of profits in the absence of some other significant connections with the jurisdiction. The consideration of these specific issues resulted in recommendations which the participating countries agreed to follow (though they are not minimum standards).

However, with respect to the more general issues raised by taxing globalised digital activities, the final BEPS product is only a report which raises various options on which countries might agree. The Final Report, issued in 2015, discusses and analyses various approaches which a generalised solution to the tax issues in the digital economy might entail. These include (i) a new nexus in the form of a significant economic presence, (ii) a withholding tax on certain types of payments for digital transactions and (iii) an equalisation levy. The Final Report justified the decision not to

17. *Action Plan on Base Erosion and Profit Shifting* (OECD, 2013) 11.
18. Tax Notes, November 11 2018, *France will Support Global Minimum Tax at G-7 Next Year*; Tax Notes, November 11, *2018 German Calls for Global Minimum Tax on Digital Companies.*

make any recommendations with respect to general approach to the taxation of the digital economy with the (excessively optimistic) assertion that the already agreed measures would likely be adequate to solve the problem.[19]

The initial work on Action1 was done by the Task Force on the Digital Economy (TFDE), a subsidiary body of the Committee on Fiscal Affairs (CFA) in which some non-OECD G20 countries participated as Associates on an equal footing with OECD countries. However, the need to have a broader level of country participation was seen as necessary and the work after 2015 was carried on by a newly constituted Task Force, operating under the Inclusive Framework, discussed above in section §1.03[C]. That Task Force issued an Interim Report in 2018 which had a more candid assessment of the views of the countries involved:

> The different perspectives on these issues among the 113 members of the Inclusive Framework can generally be described as falling into three groups. The first group considers that the reliance on data and user participation may lead to misalignments between the location in which profits are taxed and the location in which value is created. However, the view of this group of countries is that these challenges are confined to certain business models and they do not believe that these factors undermine the principles underpinning the existing international tax framework. Consequently, they do not see the case for wide-ranging change.
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> A second group of countries take the view that the ongoing digital transformation of the economy, and more generally trends associated with globalization, present challenges to the continued effectiveness of the existing international tax framework for business profits. Importantly, for this group of countries, these challenges are not exclusive or specific to highly digitalized business models.
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> Finally, there is a third group of countries that consider that the BEPS package has largely addressed the concerns of double non-taxation, although these countries also highlight that it is still too early to fully assess the impact of all the BEPS measures. These countries are generally satisfied with the existing tax system and do not currently see the need for any significant reform of the international tax rules.
>
> Acknowledging these divergences, members agreed to undertake a coherent and concurrent review of the 'nexus' and 'profit allocation' rules – two fundamental concepts relating to how taxing rights are allocated between jurisdictions and how profits are allocated to the different activities carried out by multinational enterprises, and seek a consensus-based solution. While it is a challenging objective, the Inclusive Framework will work towards a consensus-based solution by 2020.[20]

The 2018 Interim Report also recognised the fact that a number of countries, unwilling to wait for a 'global' solution, had already taken so-called interim measures, feeling that there was a 'fiscal and political imperative' to act in advance of any global solution. The Report expressed the pious wish that such interim measures 'take into account some constraints, including that any such measures should be in compliance with existing international obligations'.[21]

19. *Addressing the Tax Challenges of the Digital Economy ACTION 1: 2015 Final Report* (OECD, 2015) 20.
20. *Brief on the tax challenges arising from digitalization: Interim Report* (OECD, 2018) 1.
21. *Id.* para. 22.

Countries enacting interim measures have in effect heeded this request, though perhaps not in the way that the Task Force presumably intended it. Many of various interim measure have been explicitly structured as taxes which would not fall under the definitions of income taxes and thus would not be constrained by the cooperatively agreed on principles in income tax treaty obligations as they are not based on net income but some broader base like gross receipts or turnover.[22] For example, the legislation establishing the Indian Equalisation is located in a separate self-contained code and is not part of the income tax law. It imposed a separate 6% levy on the 'gross consideration' paid for certain 'Specified Services' defined to include online advertising, provision of digital advertising space and any other service provided in connection with online advertising.[23] Other countries have taken a similar approach.

The results of these developments will be potential double taxation of the economic flows generated by the digital activities, once under the source country excise tax and possibly again within the framework of the income tax in the resident country. Thus, in a sense, we are back to where we were in 1925 with conflicting claims for revenue and for taxing jurisdiction potentially resulting in double taxation and a corresponding burden on international commerce.

There are other strands at work here. The United States has objected to the digital tax measures proposed by the European Union (EU) on the grounds that they are in fact aimed at United States high-tech companies operating in Europe. In addition, many countries, especially the BRICS, are dissatisfied with the current rules which limit the amount of income which a source country can tax in the absence of some physical presence and are looking for some greater recognition of the claims of the market country. The recent change in the UN Model Convention regarding the right to tax services is a step in this direction.[24]

§1.05 IMPACT OF THE UNITED STATES TAX REFORM

A number of the themes discussed above are reflected in the recently enacted United States tax reform. With respect to tax competition and tax rates, the reduction of the basic statutory rate from 35% to 21% was clearly influenced by the desire to attract foreign investment and to reduce the tax burden on United States corporations with mostly domestic operations which might be tempted to move operations abroad.

With respect to United States multinationals with extensive foreign operations, the picture is more complicated. The potential residual tax burden on repatriated foreign profits on which United States tax would have been due under the prior system has been eliminated. It has been replaced by a dividend exemption system, similar to that currently applicable in a number of European countries, Australia, Canada and

22. *Id.* paras 15-19.
23. Indian Finance Act, 2016, Chapter (VII) Equalization Levy.
24. *United Nations Model Double Taxation Convention between Developed and Developing Countries* (2017), Article 12 A.

Japan.[25] For repatriated profits on which United States tax has been deferred under the prior system, however, a one-time 'repatriation tax' is applicable which will increase temporarily the tax burden.

In addition, and significant in the context of tax competition, the United States legislation has introduced several new tax regimes which bear both on tax competition for investment and tax competition for revenues. With regard to outbound investment, a current 'minimum tax' of 10.5% (one half of the generally applicable United States rate of 21%) is imposed on 'global low taxed intangible income' (GILTI) with a foreign tax credit for 80% of the foreign taxes paid on such income. The tax applies to controlled foreign corporations of the United States parent and is modelled on (but not identical to) the existing Subpart F regime.

The new tax is misnamed since it is not in fact limited to intangible income but in many cases would be applicable to most of United States corporations' foreign income. Thus deferral and residual tax on repatriated corporate foreign income are replaced by the exemption of some forms of repatriated income coupled with a current tax on 'GILTI' income at a reduced rate. Though the rules are technically (and unnecessarily) complex, the overall impact of the provision is to in effect encourage the development of a worldwide domestic tax rate of 13.125%. Given the preferential United States rate of 10.5% on the GILTI income and a foreign tax credit limited to 80% of the foreign tax paid, a country can impose a tax rate up to that level and the tax will have no impact on potential United States inward investment since the 80% foreign tax credit available will offset the GILTI tax. Of course, non-United States investment would be affected by the tax rate, but the ability to attract United States investment at in effect no cost to the United States investor is an important consideration in setting the domestic rate for many countries. Thus the United States may, intentionally or not, be setting a floor on the potential 'race to the bottom' in the attempt to attract domestic investment.

The GILTI tax also has an aspect related to tax competition for revenues. The United States will potentially be imposing a current income tax on the results from activities which have also been taxed under the 'interim measures' enacted with regard to digital activities. The United States extension of such a broad-based current tax on the foreign income of the CFCs of United States MNEs is part of the tax competition for revenues; Subpart F rules in the past have generally been limited to passive and base company income and have been aimed at tax avoidance structures.

A second new regime is in effect the United States version of a patent box. Through some complicated provisions, a special reduced rate of 13.125% is applicable to 'foreign-derived intangible income' (FDII). The definitional elements of the regime make it applicable in effect to income from export activities. The structure thus results in a 'preferential tax regime', and the issue is whether it would be viewed as harmful under the modified test developed by the FHTP discussed in section §1.02[C]. There is no requirement of 'substantial activities' in the United States or any connection with

25. Given the impact of the continued application of Subpart F and the new GILTI tax, discussed below, requiring current taxation of foreign income, for many United States corporations the dividend exemption will have little impact. It is thus misleading to view the new United States rules as moving significantly in the direction of a territorial system.

research and development costs, the proxy used for substantial activities by the FHTP. The United States argues that the intent of the regime is not to attract foreign investment but to encourage United States corporations to repatriate their current intangibles and to eliminate the incentive to transfer intangibles abroad. It is clear that the FHTP will be examining the FDII provisions.

Finally, the new 'base erosion and anti-avoidance tax' (BEAT) tax regime functions as an 'add-on' minimum tax on United States investment by foreign corporations. The tax applies to United States corporations which are significantly reducing their United States tax liabilities through deductible payments to related foreign parties. It is principally aimed at foreign-owned United States corporations. To nullify the tax advantages of such 'base eroding' payments, the corporation must pay a tax which is the greater of its normal tax liability or a tax computed at a 10% rate on its normal tax base with the 'base eroding' payments added back and no credit for foreign taxes paid. The measure may potentially result in unrelieved double taxation, as the non-deducible payments will nonetheless be taxed in full in the hands of the recipients and may not be viewed as creditable under existing rules for the relief of double taxation.

§1.06 IS COOPERATION ALWAYS A GOOD THING, ESPECIALLY FROM THE PERSPECTIVE OF DEVELOPING COUNTRIES?

The work of the OECD has been premised on the proposition that cooperation in tax matters is a good thing and a cure to the problems generated by the various forms of tax competition. In the absence of cooperation, 'the replacement of the current consensus-based framework by unilateral measures … could lead to global tax chaos marked by the massive re-emergence of double taxation'.[26]

Not all observers share this view, however. Two decades ago in the context of the initial development of standards to identify harmful tax competition in 1998, an official of the International Monetary Fund observed that for developing countries, the use of ring-fenced regimes to attract foreign investment might be a useful device to increase domestic investment.[27] It would allow the country to enjoy the positive spillover effects of the foreign investment but at the same time allow the country to generate much needed domestic revenue by imposing its normal tax rates on less mobile domestic activities, for example natural resources. The interests of residence countries could be satisfied with adequate exchange of information procedures, so those countries would have the information necessary to tax the foreign income if they wished, for example by CFC rules.

Others have raised more fundamental objections to tax cooperation from the point of view of developing countries when it involves negotiations with larger, more

26. *Base Erosion and Profit Shifting Action Plan* (OECD 2013) 10-11.
27. Michael Keen, *Preferential Regimes Can Make Tax Competition Less Harmful*, 54 National Tax Journal 714 (2001).

economically powerful countries.[28] Under the mantra of tax cooperation, these countries are often coerced into adopting measures which are not in their own interests when the overall situation is taken into account. In the context of the BEPS project, for example, developing countries wishing to have a famous ‘seat at the table’ in the Inclusive Framework and an ‘equal voice’ in the deliberations have had to agree to minimum standards which will be very difficult if not impossible for many of them to meet. The administrative and personnel resources needed to even begin complying with the minimum standards could arguably be better spent on domestic revenue mobilisation. Similarly, in the context of the agreeing on the principles for taxing the digital economy, a representative of the United Nations, a staunch advocate of the interests of developing countries, has stressed the need for ‘policy space’ for the developing countries to develop their own solutions to some of these issues.[29] Thus from these perspectives, increased international cooperation is not an unmixed blessing.

§1.07 WHERE DO WE GO FROM HERE?

As the above survey shows, there has been a dramatic increase in the various institutional mechanisms and agreements which support international tax cooperation. But the question remains as to whether the institutional structures which have been developed with respect to cooperation regarding attracting foreign investment can generate a solution to the issues regarding revenue competition. Agreement on exchange of information and transparency is much easier to achieve than agreement on substantive tax rules which limit a countries’ sovereign right to determine the tax base. The progress with respect to some of the items in the BEPS agenda is encouraging, and some principles have been agreed on regarding how to tax income which has previously not been taxed or taxed at inappropriately low rates prior to BEPS. However, the developments with respect to the digital economy are mixed. The spread of ‘interim measures’ is ongoing. Once established and generating significant revenues, such measures will be difficult to eliminate. On a more encouraging note, the EU Commission, which had originally proposed an ‘interim’ digital services tax has since agreed to postpone action until the results of the Task Force on the Digital Economy are completed in 2020. It remains to be seen, however, whether the cooperative structures developed up to this point will enable countries to achieve a satisfactory resolution to the problems of tax competition generally.

28. Tsilly Dagan, *International Tax Policy between Competition and Cooperation* (Cambridge Univ. Press, 2018).
29. Michael Lennard, *Act of creation: the OECD test of ‘Value Creation’ as a basis for taxing rights and its relevance to developing countries*, 25 United Nations Conference on Trade and Development, Transnational Corporations 55 (2018).