Curtin Law School

A Theoretical Basis for a Multilateral Tax Treaty

Robert Hynes
0000-0002-4169-9378

**This thesis is presented for the Degree of
Doctor of Philosophy
of
Curtin University**

June 2022

A THEORETICAL BASIS FOR A MULTILATERAL TAX TREATY

Robert Hynes

Issues for examination

The growing incidence of tax base erosion and profit shifting ('BEPS'), which is in a large part attributable to tax avoidance strategies by multinational enterprises, was conservatively estimated by the Organisation for Economic Co-operation and Development ('OECD') in 2021 at USD 100 to 240 billion per annum. This is a major concern, particularly for national governments that are facing an increasingly difficult battle to preserve their national tax bases. The international tax regime currently consists of a labyrinth of over 3,500 bilateral tax treaties, many of which are based on the OECD Model Convention with Respect to Income and Capital ('OECD Model'). Although initially successful, many consider the OECD Model to be outdated and increasingly inefficient in preventing BEPS.

In 2015, the OECD finalised a 15-point action plan to reduce BEPS, which included a proposal to develop a multilateral instrument pursuant to Action 15, to amend the current bilateral network. This has further complicated the international tax regime. At the same time, there exist precedents for multilateral tax treaties in both tax law and public international law. Furthermore, the evaluative literature supports the view that the bilateral architecture of the OECD Model, itself, is a significant facilitator of BEPS. The achievements of the OECD in developing and obtaining agreement on the BEPS Multilateral Instrument demonstrate that the OECD as the de facto global tax authority arguably possesses the influence and skills to develop a multilateral tax treaty. Despite this, the concerted anti-BEPS activities by the OECD since 2013 have, as at 30 June 2022, produced no proof that the loss of tax revenue through BEPS has been reduced.

In summary, this thesis argues that given the increasingly complicated international tax regime, a multilateral tax treaty should be developed to combat base erosion and profit erosion in a more effective way than the existing bilateral tax treaty network. This argument will be examined and analysed to support the following hypotheses:

1. The bilateral architecture of the current international tax treaty network, and the individual domestic tax rules it has generated, are significant facilitators (rather than inhibitors) of base erosion and profit shifting.

2. A multilateral tax treaty can, at least theoretically, be more effective in combatting base erosion and profit shifting than the current bilateral tax treaty network which can and should be developed by the OECD as a de facto global tax coordination body.

Declaration

This is to certify that:

A. the thesis comprises only my original work,
B. due acknowledgment has been made in the text to all other material used,
C. the thesis is less than 100,000 words in length, exclusive of tables, maps, bibliographies, and appendices.

Signed………………………
Robert Hynes

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List of Acronyms

APA	Advance Pricing Agreement
AT1	Additional Tier 1
ATO	Australian Taxation Office
ATP	Aggressive Tax Planning
BEPS	Base Erosion and Profit Shifting
CbC	Country-by-Country
CbCR	Country-by-Country Report
CCCTB	Common Consolidated Corporate Tax Base
CFA	Committee on Fiscal Affairs
CFC	Controlled Foreign Company
CFE	Controlled Foreign Entity
CFP	Controlled Foreign Partnerships
CFT	Controlled Foreign Trusts
CIAT	Inter-American Centre of Tax Administrations
CIT	Corporate Income Tax
CTA	Covered Tax Agreement
DTA	Double Tax Agreement
EC	European Commission
EU	European Union
FATCA	Foreign Account Tax Compliance Act
FDI	Foreign Direct Investment
FTA	Forum on Tax Administration
GAAR	General Anti-Avoidance Rules
GATT	General Agreement on Tariffs and Trade
GDP	Gross Domestic Product
GFC	Global Financial Crisis
GCI	Global Corporate Income
GloBE	Global Anti-Base Erosion
IBFD	International Bureau of Fiscal Documentation
ICT	Information and Communication Technology
IDB	Inter-American Development Bank
IMF	International Monetary Fund
IP	Intellectual Property
ITD	International Tax Dialogue
MAP	Mutual Agreement Procedure

MLI	Multilateral Instrument
MNE	Multinational Enterprises
MTT	Multilateral Tax Treaty
OECD	Organisation for Economic Cooperation and Development
OEEC	Organisation for European Economic Cooperation
PE	Permanent Establishment
PPT	Principal Purpose Test
R&D	Research and Development
SAARC	South Asian Association for Regional Development
SAARC	South Asian Association of Regional Co-operation
SLOB rule	Simplified Limitation on Benefits rule
SPE	Special Purpose Entity
TAG	Technical Advisory Group
TP	Transfer Pricing
UK	United Kingdom
UN	United Nations
VAT	Value-Added Tax
VCLT	Vienna Convention on the Law of Treaties
WTO	World Trade Organization

CHAPTER 1: INTRODUCTION

1.1 The International Taxation Regime

This thesis was last reviewed on 30 June 2022 and is current as at that date. International taxation law is highly technical and was until recently perceived as one of the last bastions of Westphalian sovereignty, with every country possessing the sovereign right to enact its own tax laws and being free to conclude tax treaties with its trading partners.[1] The current international tax regime is comprised of over 3,500 bilateral tax treaties, based largely on the OECD Model Tax Convention on Income and on Capital (Full Version), which was developed in the 1920s, and Commentaries. From the very beginning, the possibility of a multilateral treaty was explored.

Following World War II in 1945, there was a concerted move towards multilateralism with the establishment of the International Monetary Fund by 26 countries to reconstruct the international payment system.[2] This was followed by the multilateral General Agreement on Tariffs and Trade ('GATT'),[3] signed by 23 countries on 30 October 1947, to regulate international commerce. The possibility of multilateral tax treaties ('MTT's) has long been considered, and there are currently several in operation.[4]

The OECD, which was formed on 30 September 1961,[5] is arguably the de facto global taxation authority, although it has no official standing in this regard and, accordingly, its outputs are not legally binding.[6] Furthermore, there is no formally recognised global taxation authority and no international taxation laws to regulate international taxation. Cross-border tax cooperation is difficult because tax is essentially distributional and tax revenues are apportioned among countries based on residence and source. The determination of taxing rights based on economic activity and value creation is also under consideration.[7]

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[1] Richard Cavendish, 'The Treaty of Westphalia' (1998) 48 (10) *History Today*.

[2] 'About the IMF', *International Monetary Fund* (Web Page) <http://www.imf.org/external/about.htm>.

[3] 'About WTO*', World Trade Organization* (Web Page) <http://www.imf.org/external/about.htm>.

[4] Richard Vann, 'A Model Treaty for the Asian-Pacific Region? (Legal Studies Research Paper No. 10/122, Sydney Law School, 2010).

[5] 'History', *OECD* (Web Page) < http://www.oecd.org/about/history/>.

[6] See, eg, 'Frequently Asked Questions: What Is the Nature of the BEPS Outputs? Are They Legally Binding?' *OECD* (Web Page) <http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm>.

[7] OECD, 'Explanatory Statement' (OECD/G20 Base Erosion and Profit Shifting Project, 2015 Final Reports, 2015) 9 www.oecd.org/tax/beps-explanatory-statement-2015.pdf ('Explanatory Statement').

Most countries when entering tax treaties adopt the bilateral OECD Model,[8] introduced in 1977, which performs the function of coordinating the interaction of otherwise separate tax regimes and regulating tax apportionment and collection. The OECD Model has required constant updating 'to address the new tax issues that arise from the evolution of the global economy'.[9] Updates to the OECD Model were published in 1994, 1995, 1997, 2000, 2003, 2005, 2008, 2010, and 2014, with the most recent update published on 21 November 2017.[10] The United Nations and the United States of America also publish model tax treaties that are based closely on the OECD Model; however, these are not examined to any depth as such an examination would duplicate the examination of the OECD model.

Multinational enterprises ('MNEs') employ a range of tax planning strategies that include exploiting gaps in the bilateral architecture of the tax treaty network to artificially shift profits to places where there is little or no economic activity or taxation.[11] These 'gaps' result from several causes, including variations in national corporate tax rates that encourage profit shifting and treaty shopping; variations in national tax laws that enable the employment of hybrid mismatch arrangements to exploit differences in the tax treatment of an entity or instrument under national laws; and variations in the taxation of income in the OECD Model. These strategies can result in MNEs earning billions annually but paying little or no tax where their economic activity occurs. These schemes are not unlawful and result to a significant extent from the failure of the global bilateral tax treaty network to deal with the combined effects of the integration of national economies, technological advancements, and the proliferation of MNEs that have combined to create globalisation and the digital economy.[12]

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[8] Ibid. 'With the adoption of the BEPS package, OECD and G20 countries, as well as developing countries that have participated in its development, will lay the foundations of a modern international tax framework under which profits are taxed where economic activity and value creation occurs'.

[9] OECD, *Model Tax Convention on Income and on Capital 2014 – Full Version* (as it read on 15 July 2014)

< https://doi.org/10.1787/9789264239081-en> (*'Model Tax Convention 2014'*).

[10] Ibid.

[11] Patrick Love, 'What is BEPS and how can you stop it?', *OECD Insights* (Web Page, 19 July 2013) <http://oecdinsights.org/2013/07/19/what-is-beps-how-can-you-stop-it/>. 'Three popular methods for (shifting profits across borders to take advantage of tax rates that are lower than in the country where the profits are made) are hybrid mismatches, special purpose entities (SPE) and transfer pricing.'

[12] Pierre Collin and Nicolas Colin, *Task Force on Taxation of the Digital Economy*: *Executive Summary,* commissioned by the Republic of France (January 2013) <https://www.hldataprotection.com/files/2013/06/Taxation_Digital_Economy.pdf>.

On 4 November 2021, 137 member jurisdictions agreed to the OECD/G20 Inclusive Framework on BEPS.[13] This is the OECD's latest attempt to effectively tax the digital economy and will be examined in greater detail in later chapters.[14]

Before moving to the analysis of base erosion and profit shifting ('BEPS'), it is important to distinguish tax evasion, which is the use of illegal means to reduce tax liability, such as lodging a fraudulent return,[15] from tax avoidance, which is the lawful arranging of tax affairs to minimise tax liability. Tax avoidance is not a recent development, but countries are experiencing increasing difficulty in effectively taxing MNEs. An example of the way BEPS operates is provided by the tax structures of Apple Inc. Apple's tax structure was critically analysed in a paper written by Antony Ting of the Sydney University Business School and published in 2014.[16]

In 2013 Apple was investigated by the US Permanent Subcommittee on Investigations, and by the Australian Senate Economics Reference Committee, for alleged tax avoidance activities. On 30 August 2016, the European Commission ('EC') published a press release in which it was alleged that Ireland illegally permitted Apple to avoid 14 billion euros in taxes. On 20 May 2021, the Senate Homeland Security Permanent Subcommittee on Investigations published an examination of Apple's tax position in Ireland.[17] The report established the following facts regarding Apple's tax position in Ireland at that time:

- Apple established Irish subsidiary companies four years after it was founded.
- Foreign sales, which account for 60% of Apple's profits, were routed through these Irish subsidiaries and taxed nowhere.
- Apple had an Irish holding company with no operations or employees at the top of its foreign operations. This company also served as a group finance company.
- Apple Inc., the U.S. parent of the whole group, pays U.S. tax on the investment earnings of this company.
- Otherwise, the investigation found no evidence of the holding company paying tax to any government. It claims tax residence nowhere.[18]

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[13] OECD, *Inclusive Framework on BEPS: Progress Report July 2019-July 2020* (OECD Publishing, 2020) ('*Inclusive Framework on BEPS'*).

[14] OECD, 'Statement on a Two-Pillar Solution to Address the Tax Challenges Arising from the Digitalisation of the Economy' (OECD/G20 Base Erosion and Profit Shifting, 8 Oct 2021) < https://www.oecd.org/tax/beps/statement-on-a-two-pillar-solution-to-address-the-tax-challenges-arising-from-the-digitalisation-of-the-economy-october-2021.pdf> ('Statement on a Two-Pillar Solution').

[15] 'Tax Evasion', *Legal Information* Institute (Web Page) <https://www.law.cornell.edu/wex/tax_evasion>.

[16] Antony Ting, 'iTax - Apple's International Tax Structure and the Double Non-Taxation Issue' (2014) 1 *British Tax Review.*

[17] Lee Sheppard, 'How Does Apple Avoid Taxes', *Forbes* (Web Page, 28 May 2013) <https://www.forbes.com/sites/leesheppard/2013/05/28/how-does-apple-avoid-taxes/?sh=743137ca20a7>.

[18] Ibid.

- Beneath the holding company was an Irish principal company that held the contracts with Apple's Chinese contract manufacturers and owned the inventory they produced. It also claims tax residence nowhere, despite having paid some tax to Ireland at a rate substantially below the statutory rate.[19]

According to data published on the Macrotrends website, the Amazon gross profit for the quarter ending June 30, 2022, was $54,810 billion. Amazon income taxes for the quarter ending June 30, 2022, were $-0.637 billion, a 173.39% decline year-over-year.[20]

The OECD, representing 38 of the world's developed countries,[21] has conducted extensive ongoing analyses of BEPS and has issued major reports, position papers, studies, and recommendations for action within the current international tax regime. A significant factor in the increase of BEPS, it will be argued, is the bilateral architecture of the treaty network based on the OECD Model, which, although well designed for a past era, has failed to prevent BEPS from increasing. Professor Richard Vann wrote in 1991 that the OECD encourages countries to adopt multilateral tax treaty ('MTT') arrangements:

> …the resolution adopting the 1977 Model encouraged groups of countries to use it as the basis of multilateral negotiations where feasible and the UN has expressed similar hopes for its model.[22]

The consolidating opposition from governments of OECD countries to the increasing incidence of BEPS, combined with an extensive public relations campaign by these governments to engage with the public on this issue, resulted in the publication of the OECD's 2013 report entitled *Addressing Base Erosion and Profit Shifting,*[23] which identified key areas of BEPS. Brauner, who in 2014 assessed the OECD's work on BEPS to that date, observed:

> … the BEPS project has very undisciplined and opportunistic roots because it evolved through a political response to media frenzy rather than an educated study of the international tax regime.[24]

This initial report by the OECD was followed up in October 2013 by a further report, entitled *Action Plan on Base Erosion and Profit Shifting*,[25] comprising thirteen Reports, including Action 15, which was a proposal to amend the current network of bilateral tax treaties by means of a multilateral instrument, thus conceding

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[19] Ibid.

[20] 'Amazon Income Taxes 2010–2022' *Macrotrends* (Web Page) <https://www.macrotrends.net/stocks/charts/AMZN/amazon/total-provision-income-taxes#:~:text=Amazon%20income%20taxes%20for%20the,a%2067.34%25%20increase%20from%202020>.

[21] 'About – Our Global Reach', *OECD* (Web Page) <http://www.oecd.org/about/membersandpartners/>.

[22] Vann (n 4) 26.

[23] OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publishing, 12 February 2013) <https://doi.org/10.1787/9789264192744-en> ('*Addressing Base Erosion and Profit Shifting*').

[24] Yariv Brauner, 'What the BEPS? (2014) 16 *Florida Tax Review* 57.

[25] OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD Publishing, 2013) <http://dx.doi.org/10.1787/9789264202719-en> ('*Action Plan on Base Erosion and Profit Shifting*').

the necessity for fundamental changes to the OECD Model.[26] In 2015, the OECD published 14 Final Reports, consisting of an Explanatory Statement and 13 Actions, which ranged from countering harmful tax practices and treaty shopping to addressing transfer pricing, interest deductibility, and transparency to explore the tax implications of the digital economy.[27]

Action 15 proposed the development of a multilateral instrument to facilitate amendment of the bilateral treaties. The OECD has admitted that this course of action was the fastest way to attempt reducing BEPS by amending tax treaties through the operation of a single instrument, rather than individually.[28] There is, however, no precedent for this in taxation law nor in public international law, with the outcome, therefore, uncertain.[29] It will be argued that this approach is flawed as it retains the bilateral architecture of the current tax treaty network that is a fundamental facilitator of BEPS.

This thesis relies on data with respect to BEPS that is collected, collated, and presented in OECD reports, although other sources, including other global agencies, national government databases, books, and scholarly articles, are also relied upon. The OECD drives the current international debate on BEPS, while a number of countries, including Australia[30] and the United Kingdom ('UK'),[31] have also published reports, studies and working papers on BEPS.

Throughout the thesis, the underlying argument is that given the increasingly complicated international tax regime, an MTT should be developed to combat base erosion and profit shifting in a more effective way than the existing bilateral tax treaty network. This argument will be examined and analysed to support the following hypotheses:

1. The bilateral architecture of the current international tax treaty network, and the individual domestic tax rules it has generated, are significant facilitators (rather than inhibitors) of base erosion and profit shifting.

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[26] OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 – Final Report* (OECD/G20 Base Erosion and Profit Shifting Project, 2015) 5 <https://doi.org/10.1787/9789264241688-en> ('*Developing a Multilateral Instrument*').

[27] 'BEPS 2015 Final Reports' *OECD* (Web Page, 2015) https://www.oecd.org/ctp/beps-2015-final-reports.htm>..

[28] 'Explanatory Statement' (n 7) 9. '…reflecting the rapidly evolving nature of the digital economy and the need to adapt quickly to this evolution.'

[29] Ibid.

[30] Treasury (Cth), *Risks to the Sustainability of Australia's Corporate Tax Base* (Scoping Paper, 24 July 2013) <https://treasury.gov.au/publication/scoping-paper-on-risks-to-the-sustainability-of-australias-corporate-tax-base>.

[31] HM Treasury and HM Revenue & Customs, *Tackling aggressive tax planning in the global economy: UK priorities for the G20-OECD project for countering Base Erosion and Profit Shifting* (March 2014) <https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/293742/PU1651_BEPS_AA_-_FINAL_v2.pdf>.

2. An MTT can, at least theoretically, be more effective in combatting base erosion and profit shifting than the current bilateral tax treaty network, which can and should be developed by the OECD as the de facto global tax coordination body.

Modelling for an MTT will be examined in Chapter 6 and would require new concepts and a degree of tax harmonisation that does not significantly infringe on the tax sovereignty of its signatories. The OECD, it will be argued, is well equipped to develop an MTT that follows on from the BEPS Action Plan accomplishments. It will also be argued that this process may be easier than generally believed, with the OECD reporting on progress pursuant to BEPS Action 15: 'about 90 countries have joined an ad hoc group to negotiate a multilateral instrument to implement the treaty-related BEPS measures which will facilitate the amendment of bilateral tax treaties in a synchronised and efficient manner.'[32] The OECD's development of the Two-Pillar Inclusive Framework program has also received widespread acceptance by tax jurisdictions.[33] This will be dealt with more fully.

In order to initiate the development of an MTT, a facilitating legal framework and administration would need to be established. The long involvement of the OECD in international taxation, together with the leadership and incentives exhibited by the OECD in the BEPS program, arguably presents the OECD as the best-credentialed organisation to administer an MTT inception. This could be achieved, theoretically, by amendment of the OECD Convention to empower the OECD to develop a Convention on Taxation Treaties that establishes international laws relating to tax treaties. A process to amend bilateral tax treaties that is binding on OECD members would need to be written into this Convention on Taxation. Amendment of the bilateral treaties by a multilateral treaty is provided for in Article 30(3) of the *Vienna Convention on the Law of Treaties*,[34] provided certain conditions are met. In time, the membership of the multilateral treaty may extend beyond the current OECD membership and generate an expanding multilateral network.

1.2 Arguments, Approach and Structure of the Thesis

The world is facing new issues that threaten every country – of paramount importance is the issue of climate change. Predictions by a diverse number of highly respected authorities, supported by visual evidence consisting of photographs provided by the United States of America National Aeronautics and Space Administration (NASA), support the theory that climate change will cause a range of problems for many countries and that dealing with climate change will require extensive cooperation within the global community. In order to be well placed, the world needs a global tax system capable of reacting swiftly to

[32] 'Explanatory Statement' (n 7) 4. 'The participation of about 90 countries in the negotiation of the multilateral instrument is also a strong signal that countries are committed to swift and consistent implementation in a multilateral context.'

[33] *Inclusive Framework on BEPS* (n 13); 'Statement on a Two-Pillar Solution' (n 14).

[34] *Vienna Convention on the Law of Treaties,* opened for signature 23 May 1969, 1155 UNTS 331 (entered into force 27 January 1980) ('*Vienna Convention*').

future challenges. This thesis will establish that the current bilateral system, whilst effective in a past era, is too complicated, confused, cumbersome, and inefficient to prevent BEPS from increasing and being capable of addressing future challenges to tax bases.

The OECD acknowledges that its Model Tax Convention on Income and Capital is failing to reduce BEPS.[35] The introduction to the OECD/G20 Base Erosion and Profit Shifting Project Explanatory Statement contains the following assertion by the OECD:

> International tax issues have never been as high on the political agenda as they are today. The integration of national economies and markets has increased substantially in recent years. This has put a strain on the international tax framework, which was designed more than a century ago. The current rules have revealed weaknesses that create opportunities for Base Erosion and Profit Shifting (BEPS), thus requiring a bold move by policy makers to restore confidence in the system and ensure that profits are taxed where economic activities take place and value is created.[36]

This example of the effect of BEPS is contained in the introduction to the OECD's Final Reports on BEPS: 'The affiliates of MNEs in low tax countries report almost twice the profit rate (relative to assets) of their global group, showing how BEPS can cause economic distortions'.[37] It is commonly accepted that many of the means employed by MNEs to minimise tax fall within the definition of tax avoidance and, as such only comply with the letter of the laws of the relevant national jurisdictions. The increasing incidence of BEPS has provided justification for the governments of OECD member countries and also members of the Group of Twenty to call for MNEs, in the form of a publicity campaign, to pay their 'fair share of tax'.

From September 2013 to 2015, the OECD convoked working groups from OECD and G20 countries, with participation by some developing countries, that produced a package of thirteen reports containing 15 Actions, including 'new or reinforced international standards as well as concrete measures to help countries tackle BEPS'.[38] According to the Foreword to Action 15 of the BEPS Action Plan, 'The BEPS package of measures represents the first substantial renovation of tax rules in almost a century'. The preamble to Action 15 of the BEPS Action Plan conceptualises the development of a multilateral instrument to 'quickly' 'enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties'.[39]

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[35] See, eg, 'Explanatory Statement' (n 7) 9. 'Globalisation has exacerbated the impact of gaps and frictions among different countries tax systems. As a result, some features of the current bilateral tax treaty system facilitate base erosion and profit shifting (BEPS) and need to be addressed.'

[36] Ibid.

[37] Ibid 4.

[38] Ibid.

[39] Ibid 18.

Given these circumstances, three related arguments will be presented in the thesis. The first argument is that the bilateral architecture of the tax treaty network based on the OECD Model, and the individual domestic tax law it has encouraged, is a significant facilitator (as opposed to being an inhibitor) of BEPS.[40] This bilateralism facilitates the exploitation of variable inter-jurisdictional tax rates and encourages the shifting of profits from those jurisdictions where the profit-making activities occurred to lower-tax or no-tax jurisdictions through various methods. Transfer pricing is generally acknowledged as the principal offender, with the use of hybrid mismatch arrangements and treaty shopping also commonly employed.[41]

Each of these activities exploits gaps and variations in tax systems and instruments, many attributable to the bilateral architecture of the treaty network. The work by the OECD, carried out with representatives from many tax jurisdictions, led to the acceptance of the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* ('Multilateral Convention'), also known as the Multilateral Instrument ('MLI'), by 67 tax jurisdictions, as of 14 December 2021.[42] The MLI is generally accepted as a multilateral treaty that enables jurisdictions to swiftly modify the operation of their tax treaties to implement measures designed to address multinational tax avoidance better and more effectively resolve tax disputes.[43] These measures were developed as part of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project.

> Australia signed the MLI on 7 June 2017, and it was given the force of law in Australia by the *Treasury Laws Amendment (OECD Multilateral Instrument) Act 2018*, which received Royal Assent on 24 August 2018. Australia deposited its instrument of ratification with the OECD Depositary on 26 September 2018, and the MLI entered into force on 1 January 2019. The extent to which the MLI will modify the operation of Australia's tax treaties will depend on the adoption positions taken by each jurisdiction at ratification, acceptance, or approval of the MLI.[44]

The second argument is that an MTT capable of reducing BEPS can and should be developed by the OECD as the de facto global tax authority. The process of stakeholder consultation would be similar to that completed by the OECD in 2015 for Action 15 of the BEPS Action Plan, referred to above. The development of an MTT as proposed raises the issue of tax multilateralism at a time when that issue

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[40] KPMG, 'OECD BEPS Action Plan – Ready or not? Global survey of tax executives' (January 2015). See Introduction: 'For today's tax executives, the future of international taxation has never been more uncertain.'

[41] See, eg, Brauner (n 24) 41. 'Aggressive transfer pricing is the beating heart of BEPS planning- the sine qua non of the transactions that triggered the universal interest in BEPS and eventually the BEPS project.'

[42] OECD, *Signatories and Parties to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (status as of 14 December 2021) <https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf> ('*Signatories and Parties to the Multilateral Convention*').

[43] 'Multilateral Instrument' *Australian Taxation Office* (Web Page, 9 June 2022) <https://www.ato.gov.au/general/international-tax-agreements/in-detail/multilateral-instrument/> ('Multilateral Instrument').

[44] Ibid.

dominates the international tax headlines. The OECD's success in obtaining an agreement to develop an instrument under Action 15 supports the view that a similar development of an MTT is feasible at this time. The processes required to implement a multilateral treaty capable of replacing or co-existing with bilateral treaties are more fully addressed in Chapter 5 of the thesis. As of 29 December 2021, there is no published proof that BEPS has been reduced.

The outcome would be a reconceptualised international tax regime, comprised principally of a multilateral treaty specifically designed to more efficiently reduce base erosion and profit shifting and with the flexibility to adjust to changing circumstances. The third argument, which follows from the preceding arguments, is that an MTT would, at least theoretically, reduce BEPS and support the fiscal policies of OECD members more effectively than the bilateral network. Intrinsic to this research is an in-depth examination of the relevant public international law, excluding an examination of national tax laws that are also a part of the international tax order. Where examinations of national laws are required, the laws of Australia are discussed. The role of the OECD as the author of various reports and other materials produced with respect to BEPS is central to the tax issues addressed in the thesis, as is the role of the United Nations with respect to the demographics of OECD countries.

The arguments in the thesis are important because the BEPS Action Plan, which includes the proposed amendment of the current bilateral tax treaty network by means of an instrument under BEPS Action 15, is, as the OECD has conceded, a hasty response to political demands. Therefore, by failing to address the bilateral architecture of the current network, the BEPS Action Plan may also fail to reduce BEPS. Furthermore, the legality of amendments intended to be affected by an amendment instrument developed pursuant to Action 15, as will be argued, is uncertain under both public international law and taxation law. Without a stable and adequate tax base, the fiscal capacity of countries to provide infrastructure, social services, and development opportunities, and thereby a stable political environment, may be threatened.[45]

The approach adopted in the thesis is first to examine whether a theoretical basis exists for the hypothesis that an MTT can theoretically reduce BEPS and whether the OECD can and should develop an MTT. Professor Vann of Sydney University identified several areas where the OECD Model became outdated in 2010 and suggested a multilateral treaty for the Asia-Pacific region.[46] In 2001, Victor Thuronyi critically

[45] Diane Ring, 'Summary Transparency, Disclosure and Developing Countries' (Conference Paper, International Tax Conference on BEPS, Sydney Australia, 18-19 November 2014).

[46] Vann (n 4). In 1991, Vann identified several problems with the OECD Model including the bilateral nature of the model; the separate taxation of members of corporate groups; schedular structure; and increasing inefficiency, irrelevance, and inflexibility. Vann proposed a multilateral treaty for the Asian-Pacific region relying upon the precedents provided by the Andean, Caricom and Helsinki multilateral treaties.

examined the potential structure and possibility of an MTT.[47] He adopted a 'comparative tax law' approach and examined the convergence of different taxation systems. Ring endorsed Thuronyi's work and suggested:

> Ultimately, the hardest problem may be pitching the proposed treaty reform as neither too revolutionary nor too incremental. The project could be viewed as too ambitious because it truly constitutes a call for a multilateral treaty and harmonization (both harmonization of treaty terms made available to different countries and harmonization of the different countries' domestic tax systems) – thereby fueling substantive and political objections to the prospect.…perhaps we should start with multilateral agreements limited to these prominent topics.[48]

If it is established that a multilateral treaty can theoretically reduce BEPS, then a theoretical basis for an MTT may be established. If, however, a theoretical basis is *not* established, then the literature supporting retention and amendment of the existing bilateral tax treaty network may be justified.

The first argument of the thesis identifies the bilateral architecture of the tax treaty network based on the OECD Model as a significant facilitator (rather than inhibitor) of BEPS. This will require an analysis of the various tax avoidance activities of MNEs that result in BEPS to determine which activities that result in BEPS are reasonably attributable to the bilateral framework of the current treaty network.

The second argument, which follows from the previous arguments, is that an MTT would, at least theoretically, reduce BEPS more effectively than the bilateral network, provided a theoretical basis is established for an MTT and provided it is established that the architecture of the OECD Model is a significant factor in the failure of the bilateral network to reduce BEPS.

Several tax authors favour an MTT. Vann suggests a multilateral tax treaty for the Asia-Pacific region based on current regional treaties.[49] Ring suggests a model that does not attempt too much and does not threaten sovereignty.[50] The administration of a multilateral network could be undertaken hypothetically by the OECD, United Nations, or World Trade Organisation. The OECD is arguably the most appropriate for the following reasons:

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[47] See Victor Thuronyi, 'International Tax Cooperation and a Multilateral Treaty' (2001) 26 *Brooklyn Journal of International Law* 1641. Larry Pressler, 'Comments on International Tax Treaties (1992) 92 *TNI* 57-16 (Senator Larry Pressler's Senate floor statement noting concerns in the tax context that "countries find it much more difficult to reach agreement on a common goal .... The interests of each nation result in unique approaches to the determination of revenue requirements, the ability to raise taxes and indeed, to the kinds of taxes upon which its system will depend."). See also Friedrich Rödler, 'Austria Proposes Multilateral Tax Treaty' (1997) 97 *TNI* 183-2 (the Austrian Ministry of Finance advocating pursuit of a multilateral tax treaty for the European Union but noting that prior efforts at a comprehensive multilateral tax treaty in the European context failed).

[48] Ring (n 45).

[49] Vann (n 4).

[50] Ring (n 45).

- the OECD is the de facto global tax authority, developed the current bilateral Model, was instrumental in designing anti-avoidance rules to address BEPS, and is orchestrating the development of the Action 15 instrument
- the OECD garnered the signatures of over 100 tax jurisdictions to accept the multilateral instrument for amending the global bilateral tax treaty network
- the OECD countries are facing escalating budgetary constraints and are arguably most affected by BEPS
- the *UN Model Double Taxation Convention* is closely based on the OECD Model and therefore suggests that the OECD is more experienced in tax treaty design and
- the World Trade Organisation has a widespread membership and vast experience in trade negotiations and agreements but lacks experience in international taxation.

The *Vienna Convention* provides procedures for parties to withdraw from a treaty (Article 65), arbitration (Article 66), and termination or suspension of the operation of a treaty because of its breach.[51] This is a matter that would need to be addressed during the development of an MTT. This thesis proposes that the current global tax regime based on the OECD and UN models should be retired in favour of an MTT to be negotiated by the OECD in consultation with willing tax jurisdictions and containing certain fundamental anti-avoidance measures contained in the MLI, as examined in detail in Chapter 9.

It would include proposals for the migration of tax jurisdictions from the current bilateral tax treaty network through a combination of the operation of the multilateral treaty and the application of the principles of public international law. The issue of amendment of the bilateral network by a multilateral instrument pursuant to Action 15 will also be considered. Article 30(3) of the *Vienna Convention on the Law of Treaties* provides:

> When all the parties to the earlier treaty are parties also to the later treaty, but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty.

The OECD's interpretation of the effect of this clause, contained in paragraph 18 of the Action 15 Final Report, is that 'when two rules apply to the same matter, the later in time prevails'.[52] The OECD then concludes that 'earlier bilateral treaties would continue to apply to the extent that their provisions are compatible with those of the later multilateral treaty'.[53] The question of whether Article 30(3) provides the

[51] *Vienna Convention* (n 34).

[52] *Developing a Multilateral Instrument* (n 26) 32.

[53] Ibid.

authority for the amendment of a network of bilateral treaties by a multilateral instrument may require judicial determination.

Adopting this approach, the thesis is organised as follows:

1. Chapter 2 analyses the international tax regime, starting with the principle of tax sovereignty and the development of tax treaties. It proceeds to examine multilateral enterprises, communications technology, the internet, the digital economy, and globalisation.
2. Chapter 3 establishes the historical foundation for the thesis, namely the OECD's history and development, and then examines the current role and standing of this major player in international tax. This chapter also examines the global bilateral tax treaty network and the recently developed multilateral instrument and processes for the development of an MTT.
3. BEPS is analysed in Chapter 4, as are the principal methods employed by MNEs to avoid tax.
4. Chapter 5 examines anti-avoidance measures employed to counter the practices described in Chapter 4 and the corresponding rules contained in Australia's legislation to suppress these practices. The deficiencies related to the OECD Model's bilateral structure that allow BEPS to increase are also examined.
5. Chapter 6 examines the circumstances surrounding the development of the multilateral instrument ('MLI') by the OECD and analyses this process.
6. Chapter 7 assesses the multilateral instrument under the application of public international law and international taxation law.
7. Chapter 8 examines certain recent developments that impact the global tax regime.
8. Chapter 9 conceptualises and implements an MTT within the current international tax environment.
9. Chapter 10 contains the summary, findings, and areas for further research.

1.3 Research Framework, Methodology, Method, and Contribution

Introduction

The purpose of this research is to identify, examine and analyse material relevant to the development of an MTT by the OECD. Specifically, this research analyses whether this approach could more successfully combat base erosion and profit erosion than the existing bilateral tax treaty network.

Framework and classification of the research to be undertaken

The Australian Standard Research Classification has attempted to classify research undertaken in Australia as falling within the following four types of activity: [54]

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[54] See Australian Bureau of Statistics, *Australian and New Zealand Standard Research Classification* (ANZSRC, 2008 1297.0), 1800 Law.

1. *Pure basic research*

This form of research is experimental or theoretical work undertaken primarily to acquire new knowledge without a specific application in view. It is performed without looking for long-term economic or social benefits other than the advancement of knowledge and includes most humanities research.[55]

2. *Strategic basic research*

This form of research is experimental or theoretical work undertaken primarily to acquire new knowledge without a specific application in view and is conducted in specific broad areas in expectation of useful discoveries. It provides the broad base of knowledge necessary for the solution of recognised practical problems.[56]

3. *Applied research*

Applied research is original work undertaken to acquire new knowledge with a specific practical application in view. Its aim is to determine possible uses for the findings of basic research or to determine new methods or ways of achieving some specific and pre-determined objective.[57]

4. *Experimental development*

Experimental development is systematic work, using existing knowledge gained from research and/or practical experience, to create new or improved materials, products, devices, processes, or services. In the social sciences, experimental development may be defined as the process of transferring knowledge gained through research into operational programs.[58]

Hutchinson comments that:

> Much legal research 'fits' within the third category of applied research, being directed to specific problems and aiming for tangible outcomes for professional use. However, legal research can be difficult to classify because of its variable contexts and facets.[59]

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[55] Terry Hutchinson, *Researching and Writing in Law* (Lawbook Co, 2006).

[56] Ibid.

[57] Ibid.

[58] Ibid 7.

[59] Ibid.

In 1987, the Pearce Committee reviewed legal research and categorised it as encompassing:

1. Doctrinal research – research which provides a systematic exposition of the rules governing a particular legal category, analyses the relationship between rules, explains areas of difficulty and, perhaps, predicts future developments.
2. Reform-oriented research – research which intensively evaluates the adequacy of existing rules and recommends changes to any rules found wanting.
3. Theoretical research – research which fosters a more complete understanding of the conceptual bases of legal principles and of the combined effects of a range of rules and procedures that touch on a particular area of activity.[60]

Methodology

According to McKerchar, taxation is an important part of everyday life and when seeking to understand taxation, research has to extend well beyond the 'study of the revenue law itself'.[61] McKerchar comments that '[t]axation is not a discipline in its own right, but a social phenomenon that can be studied through various disciplinary lenses'.[62] McKerchar, by way of example, suggests that although legal researchers may be equipped to study the meaning of the letter of the law, they may not be as well-equipped as other professions to assess how people respond to the law.[63]

In 2005, Lamb et al. argued that tax is not a discipline in itself but rather a multidisciplinary field of research encompassing the disciplines of law, accounting, economics, political science and social policy.[64] McKerchar observed in 2010 that 'tax is a social construct that can be studied through many and various disciplinary lenses'.[65] The taxation research that was undertaken in this work required a gathering of knowledge in the disciplines of law, economics and political science, although legal research overwhelmingly dominated. The questions that the research found answers to, concerned the continued failures of the bilateral tax treaty network based mainly on the 1977 OECD Model Tax Treaty to reduce

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[60] Ibid 7, quoting D Pearce, E Campbell and D Harding ('Pearce Committee'), *Australian Law Schools: A Discipline Assessment for the Commonwealth Tertiary Commission* (Australian Government Publishing Services, 1987) vol 3, 17.

[61] Margaret McKerchar, 'Philosophical Paradigms, Inquiry Strategies and Knowledge Claims: Applying the Principles of Research Design and Conduct to Taxation' (2008) 6(1) *eJournal of Tax Research* 5–22.

[62] Ibid.

[63] Ibid.

[64] M. Lamb, 'Interdisciplinary Taxation Research – An Introduction' in M. Lamb, A. Lymer, J. Freedman, and S. James (eds), *Taxation: An Interdisciplinary Approach to Research* (Oxford University Press, 2005) 4.

[65] Margaret McKerchar, *Design and Conduct of Research in Tax, Law, and Accounting* (Thomson Reuters, 2010).

BEPS. This research fell within the ‘Expository Research’ quadrant of legal research styles developed by Chynoweth.[66] Thus the methodology that was most appropriate for this research was doctrinal.

Research is commonly described as being either basic research, which is theoretical rather than practical, or applied research, which is usually associated with investigating a problem, such as the failure of the current tax treaty regime to reduce BEPS.[67]

Method — Applying Doctrinal Research to Tax Research

Legal scholars collect data from primary sources (statutes and cases) to develop hypotheses on their meaning and scope. This is supplemented by using secondary sources, including scholarly articles, reports, and books. Taken together, they build theories, which they test and from which new hypotheses are derived. From this, legal scholars identify doctrines that are tested using the classic canons of interpretation and that are subsequently applied in order to resolve similar factual or legal issues. Described in this way, doctrinal legal scholarship fits perfectly with the methodology of the disciplines encompassed within the scope of tax research. According to Hutchinson under the classic law research paradigm, the doctrinal methodology is the preferred methodology for tax law reform and public policy research studies.[68]

1.4 Literature Review

BEPS has been addressed in several OECD publications dating back to the publication of the report on *Harmful Tax Competition* by the OECD’s Committee on Fiscal Affairs in 1998.[69] Since then, the OECD has driven the BEPS debate and formulated the opposition to BEPS.[70] Until 2013, this opposition comprised of co-operation and reporting and the introduction of a raft of anti-avoidance measures into national legislation, often on the recommendation of the OECD, including, for example, transfer pricing rules.[71] In 2011, the OECD published the OECD *Guidelines for Multinational Enterprises,* which contained non-binding principles and standards for responsible business conduct, inter alia in the area of taxation.[72]

The problems with the OECD Model have been extensively documented and include ‘the inconsistency of the bilateral network with the multilateral nature of business, limitations of existing treaties on unilateral

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[66] P. Chynoweth, ‘Legal research’ in A. Knight and L. Ruddock (eds), *Advanced Research Methods in the Built Environment* (Wiley-Blackwell, 2008) 28–38.

[67] McKerchar (n 65), 6.

[68] Terry Hutchinson, *Researching and Writing in Law* (Thomson Reuters, 2nd ed, 2010) 21.

[69] OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publishing, 1998) <https://doi.org/10.1787/9789264162945-en>.

[70] Pascal Saint-Amans and Raffaele Russo, ‘What the BEPS Are We Talking About?’ *OECD Forum* (Web Page, 2013) <https://www.oecd.org/forum/oecdyearbook/what-the-beps-are-we-talking-about.htm>.

[71] *Income Tax Assessment Act 1997* (Cth). Subdivisions 815-B, 815-C and 815-D contain Australia’s transfer pricing rules last amended in 2013.

[72] OECD, *OECD Guidelines for Multinational Enterprises* (OECD Publishing, 2011) 60.

action, incomplete coverage of countries, inability to deal with triangular taxation issues, problems of interpretation and amendment and tax treaty abuse'.[73] Other issues to be resolved are how to tax business profits and how to deal with the digital economy. Countries like the USA are unlikely to surrender taxation rights based on residence, although Pinto and others have made a case for taxation at source (and multilateralism).[74] Pinto analysed the failure of national tax laws to adapt to the advent of the digital economy in his 2014 address delivered at the International Tax Conference on BEPS.[75] He further considered the issue of taxation rights based on the economic activity that produces the business profits.

The New Zealand High Court addressed hybrid mismatches in 2013,[76] and in 2015, Dyreng et al provided an example of how multinationals conduct their affairs in examining 'the global equity supply chains of U.S. multinationals to explore how tax and nontax country characteristics affect whether firms use foreign holding companies and where they locate them'.[77] The result of their studies was that U.S. multinationals supply equity to their foreign operating companies through holding companies located in low-tax jurisdictions.[78] This is not new. In 1961, President Kennedy made the following statement:

> Recently more and more enterprises organised abroad by American firms have arranged their corporate structures aided by artificial arrangements between parent and subsidiary regarding intercompany pricing, the transfer of patent licensing rights, the shifting of management fees, and similar practices ... in order to reduce sharply or eliminate completely their tax liabilities both at home and abroad.[79]

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[73] Sunita Jogarajan, 'A Multilateral Tax Treaty for ASEAN – Lessons for the Andean, Caribbean, Nordic and South Asian Nations' (2011) 6 *Asian Journal of Comparative Law* 1, 5-6. Jogarajan comments on a problem with the intra-ASEAN bilateral tax treaty network: 'A 2005 study found, however, that the existing bilateral tax treaty network was limited as member countries generally did not have treaties with all other members and often provided non-ASEAN members with more favourable terms that ASEAN members.'

[74] Dale Pinto, 'The Continued Application of Source-Based Taxation in an Electronic Commerce Environment' (PhD Thesis, University of Melbourne, 2002) ('The Continued Application of Source-Based Taxation'). At page 273 Pinto states: 'Of even greater interest will be to see whether the international community decides that a need for a more comprehensive, more formal and more inclusive multilateral forum, that is similar to the World Trade Organisation for trade matters, may be needed to secure international consensus to accommodate the challenges that electronic commerce may present for tax laws.' Further on page 275: 'Given these deficiencies, and in light of the continuing challenges that electronic commerce may present to international tax laws, consideration may need to be given–sooner rather than later– to broaden the extent of international tax co-operation in tax matters so that it truly becomes multilateral through the establishment of some form of international World Tax Organisation'.

[75] Dale Pinto, 'A Preliminary Analysis of Potential Options to Address the Tax Challenges Raised by the Digital Economy' (Conference Paper, International Tax Conference on BEPS, Sydney, Australia, 18-19 November 2014) ('A Preliminary Analysis'). Pinto addresses the challenges global tax bases by the digital economy and concludes at page 54: 'Finally it is submitted that the approach taken by the OECD in not ring-fencing the digital economy from the rest of the economy for tax purposes … given that the digital economy is increasingly becoming the economy itself'.

[76] *Alesco New Zealand Ltd v C of IR* (2013) 26 NZTC 21-003.

[77] S. Dyreng, B. Lindsey, K. Markle and D. Shackleford, 'The effect of tax and nontax country characteristics on the global supply chains of U.S. multinationals' (2015) 59 *Journal of Accounting and Economics* 182-202.

[78] Ibid.

[79] Saint-Amans and Russo (n 70).

The debate over BEPS by high-profile MNEs has now reached the highest levels of governments and is receiving growing media attention, which has stimulated public debate within the populations of OECD countries. It is estimated that by the end of 2017, U.S. multinationals held more than $1 trillion in profits offshore via mechanisms such as the Double Irish and the Dutch Sandwich.[80] This has pressured the OECD, the author of the OECD Model at the centre of the debate, to give the BEPS problem its highest priority and has produced a series of reports addressing the BEPS problem. As a follow-up to the 2013 OECD Report, action was taken to lift the level of cooperation between countries to share tax information and to address these issues in a coordinated, comprehensive manner, which the G20 leaders and finance ministers endorsed at the summit in St. Petersburg in September 2013.[81] Several countries, including the United States,[82] the United Kingdom,[83] and Australia,[84] have held parliamentary enquiries into tax avoidance by various MNEs.

On 19 July 2013, the OECD published its *Action Plan on Base Erosion and Profit Shifting,* which consisted of 15 Actions to address the increasing incidence of BEPS. [85] The final package of measures was released on 5 October 2015.[86] Action 15 of this package proposed the development of a multilateral instrument to enable

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[80] Charlie Taylor, 'Google used "Double-Irish" to shift $75.4 bn in profits out of Ireland', *The Irish Times* (Dublin, 17 April 2021).

[81] Russia G20, *G20 Leaders' Declaration 2013* (Web Page) <http://en.kremlin.ru/events/president/news/19167>.

[82] Eg, Homeland Security and Government Affairs, Permanent Subcommittee on Investigations, Hearing on 'Offshore Profit Shifting and the U.S. Tax Code - Part 2 (Apple Inc.)', 21 May 2013, < https://www.hsgac.senate.gov/subcommittees/investigations/hearings/offshore-profit-shifting-and-the-us-tax-code_-part-2.

[83] HM Treasury, HM Revenue & Customs (n 31). AP15: Develop a multilateral instrument. Through analysing international tax and public law, a multilateral instrument will be designed which will enable participating jurisdictions to implement BEPS measures and enhance bilateral tax treaties. The UK is committed to this process and is working with others to devise effective solutions that reflect the rapidly evolving nature of the global economy, and the need to adapt quickly to this evolution. This work will accelerate over the coming months as the substantive outcomes of the project emerge.

[84] Treasury (n 30).

[85] *Action Plan on Base Erosion and Profit Shifting* (n 25).

Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules.

Action 13:

Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business.

Action 14:

Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.

[86] 'BEPS 2015 Final Reports' (n 27)

Action 1: Addressing the Tax Challenges of the Digital Economy

Action 2: Neutralising the Effects of Hybrid Mismatch Arrangements

Action 3: Designing Effective Controlled Foreign Company Rules

the amendment of the existing bilateral treaty network based on the OECD Model.[87] The OECD acknowledged that no precedent in taxation law or public international law exists that establishes a foundation for this instrument.[88] As of 21 October 2021, the multilateral instrument under Action 15 had been signed by 96 tax jurisdictions.[89]

Since the publication of *Addressing Base Erosion and Profit Shifting in 2013,* the OECD has worked without respite to reduce BEPS, which is evidenced by the publication of over 30 reports dealing with BEPS.[90]

Action 4: Limiting Base Erosion Involving Interest Deductions and Other Financial Payments

Action 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status

Actions 8-10: Guidance on Transfer Pricing Aspects of Intangibles

Action 11: Measuring and Monitoring BEPS

Action 12: Mandatory Disclosure Rules

Action 13: Guidance on Transfer Pricing Documentation and Country-by-Country Reporting

Action 14: Making Dispute Resolution Mechanisms More Effective

Action 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

[87] OECD, 'Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS' (OECD/G20 Base Erosion and Profit Shifting Project, 2015) <https://www.oecd.org/ctp/beps-action-15-mandate-for-development-of-multilateral-instrument.pdf>.

[88] Ibid 9. 'The goal of Action 15 is to streamline the implementation of the tax treaty-related BEPS measures. This is an innovative approach with no exact precedent in the tax world'.

[89] *Signatories and Parties to the Multilateral Convention* (n 42), status on 28 October 2021.

[90] *Action Plan on Base Erosion and Profit Shifting* (n 25); 'BEPS 2015 Final Reports' (n 27); 'Explanatory Statement' (n 7); *Inclusive Framework on BEPS* (n 13); OECD, *Additional Guidance on the Attribution of Profits to a Permanent Establishment Inclusive Framework on BEPS: Action 7* (OECD Publishing, March 2018) < https://www.oecd.org/tax/transfer-pricing/additional-guidance-attribution-of-profits-to-permanent-establishments-BEPS-action-7.pdf>; OECD, *Corporate Tax Statistics Database – First Edition* (OECD Publishing, 2019) <https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-database-first-edition.pdf>.

OECD, *Country-by-Country Reporting – Compilation of Peer Review Reports (Phase 1)Inclusive Framework on BEPS: Action 13* (OECD Publishing, 23 March 2018) https://www.oecd.org/publications/country-by-country-reporting-compilation-of-peer-review-reports-phase-1-9789264300057-en.htm>; OECD, *Country-by-Country Reporting Status Message XML Schema: User Guide for Tax Administrations* (OECD Publishing, 2017) https://www.oecd.org/tax/beps/country-by-country-reporting-status-message-xml-schema-user-guide-for-tax-administrations.htm; OECD, *Exchange on Tax Rulings Status Message XML Schema: User Guide for Tax Administration* (OECD Publishing, 2017) < https://www.oecd.org/tax/beps/exchange-on-tax-rulings-status-message-xml-schema-user-guide-for-tax-administrations.htm>; OECD, *Guidance for Tax Administrations on the Application of the Hard-to-Value Intangibles Approach Inclusive Framework on BEPS: Action 8* (OECD Publishing, 2018) < https://www.oecd.org/tax/transfer-pricing/guidance-for-tax-administrations-on-the-application-of-the-approach-to-hard-to-value-intangibles-BEPS-action-8.pdf>; OECD, *Guidance on Country-by-Country Reporting Inclusive Framework on BEPS: Action 13* (OECD Publishing, 2018) < https://www.oecd.org/tax/beps/guidance-on-country-by-country-reporting-beps-action-13.htm>; OECD, *Harmful Tax Practices – 2017 Progress Report on Preferential Regimes Inclusive Framework on BEPS: Action 5* (OECD Publishing, 2017) < https://www.oecd.org/tax/beps/harmful-tax-practices-2017-progress-report-on-preferential-regimes-9789264283954-en.htm>; OECD, *Harmful Tax Practices – 2017 Peer Review Reports on the Exchange of Information on Tax*

There have been proposals for multilateral tax treaties as far back as 1997 when Michael Lang, Josef Schuch, Christoph Urtz and Mario Zuger proposed an EU MTT in their book *Multilateral Tax Treaties.*[91] Marjaana Helminen of the University of Helsinki, in her book *The Nordic Multilateral Tax Treaty as a Model for a Multilateral EU Tax Treaty,* proposed the Nordic MTT as a model for a multilateral EU tax treaty.[92] She advanced the argument that '[a] multilateral tax treaty could resolve many of the international tax law problems not resolved by the bilateral tax treaties concluded by the EU Member States'. [93] Helminen identified many of the same problems with the OECD Model as Vann in his 1991 journal article that advanced his theory for a multilateral treaty for the Asia-Pacific region upon the foundation provided by the Andean, Caricom and Helsinki multilateral treaties.[94]

It follows from this that the literature is subject to the following dichotomy:

- the OECD Model is capable of reducing BEPS and should be retained with amendments and support in the form of anti-avoidance activities; and
- the OECD Model is outdated and incapable of reducing BEPS and should be replaced, preferably with an MTT.

The first argument supports the view that the current international tax regime, based on the bilateral OECD Model, is capable of reducing BEPS via amendments to the OECD Model. Pascal Saint-Amans, a Director of the OECD Centre for Tax Policy and Administration, endorsed this view with the following comment: 'The action plan will provide comprehensive, coordinated strategies for countries concerned with BEPS, while at the same time ensuring a certain and predictable environment for business'.[95] Although the OECD is of this view, tax authors have predicted since the 1980s that national governments will experience

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Rulings Inclusive Framework on BEPS: Action 5 (OECD Publishing, 2018) < https://www.oecd.org/tax/beps/harmful-tax-practices-2017-peer-review-reports-on-the-exchange-of-information-on-tax-rulings-9789264309586-en.htm>; OECD, *Harmful Tax Practices – 2016 Peer Review Reports on the Exchange of Information on Tax Rulings Inclusive Framework on BEPS: Action 5* (OECD Publishing, 2017) <https://www.oecd.org/tax/beps/harmful-tax-practices-peer-review-reports-on-the-exchange-of-information-on-tax-rulings-9789264285675-en.htm>; OECD, 'OECD/G20 Inclusive Framework on BEPS: Progress Report July 2017-June 2018' < https://www.oecd.org/tax/beps/inclusive-framework-on-beps-progress-report-july-2017-june-2018.pdf>; OECD, *Peer Review and Monitoring Process of the Four Minimum Standard* (OECD Publishing, 2016-2020); OECD, 'Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries' (2014) < https://www.oecd.org/tax/tax-global/report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf; OECD, *Revised Guidance on the Application of the Transactional Profit Split Method Inclusive Framework on BEPS: Action 10* (OECD Publishing, 2018) < https://www.oecd.org/tax/transfer-pricing/revised-guidance-on-the-application-of-the-transactional-profit-split-method-beps-action-10.htm>; OECD, *Tax Challenges Arising from Digitalisation – Interim Report 2018 Inclusive Framework on BEPS* (OECD Publishing, 2018) < https://www.oecd.org/ctp/tax-challenges-arising-from-digitalisation-interim-report-9789264293083-en.htm>.

[91] Michael Lang, Josef Schuch, Christoph Urtz and Mario Zuger, *Multilateral Tax Treaties* (Kluwer Law & Taxation, 1998).

[92] Marjaana Helminen, *The Nordic Multilateral Tax Treaty as a Model for a Multilateral EU Tax Treaty* (IBFD, 2014).

[93] Ibid.

[94] Vann (n 4).

[95] Saint-Amans and Russo (n 70).

increasing difficulties in sustaining their corporate tax bases (under the current regime) as mobile capital increases with globalisation.[96] In contrast, Devereux and Sorensen support the retention of the existing OECD Model-based network but made recommendations that question the effectiveness of the corporate income taxes and predict a race to a zero corporate tax rate through tax competition.[97]

In 2013, the Australian Government investigated the sources of risk to Australia's corporate tax base via a *Scoping Paper* prepared by the Treasury.[98] According to this report, Australia, in general terms, supports the OECD policy and the amendment of the OECD Model by a multilateral instrument pursuant to Action 15. As such, it supports the move away from a worldwide taxation model towards a territorial tax system for active business income.[99]

Yariv Brauner also supports the approach adopted by the OECD Action Plan but questions the haste with which the OECD tackled the BEPS problem after OECD countries applied pressure:

> This concern (that the OECD is treading in the familiar territories of traditional and limited doctrinal analysis) is exacerbated by the choice of the OECD – explained perhaps by the tight timeframe – to aspire only to a report about the challenges presented by the digital economy.[100]

Brauner's article contains a general analysis of the OECD's work on BEPS up to March 2014, concluding that 'the BEPS program presents a mix of promise and concern as it proceeds to reform the international tax regime'.[101] He also observed, while supporting the Action 15 proposal, that

> …the awkward statement of intent, 'preservation of the bilateral structure', should be reconsidered. If this is indeed a multilateral project intended to provide useful solutions through coordination, it is the coordination and multilateralism that must be emphasised from the beginning and not bilateralism as such'.[102]

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[96] See, eg, Roger Gordon, 'Taxation of Investment and Savings in a World Economy' (1986) 76(5) *American Economic Review* 1086 – 1102. See also Michael P. Devereux and Peter Birch Sorensen, 'The Corporate Income Tax: International Trends and Options for Fundamental Reform' (Economic Papers No 264, European Commission, December 2006). The authors investigate various reform options and make the following observation on the mobility of profits and capital 'Specifically, irrespective of where they locate their real economic activity, multinational corporations active in many countries may be able to shift profits between countries to take account of favourable tax treatment. It is possible – indeed likely – that profit is actually more mobile than capital'.

[97] Devereux and Sorensen (n 96), 3.

[98] Treasury (n 30).

[99] Ibid 12.

[100] Brauner (n 24).

[101] Ibid 59.

[102] Ibid 38.

While accepting a multilateral treaty as theoretically superior to the bilateral network in addressing BEPS, Brauner concludes that the process of migrating from a bilateral network to a multilateral treaty would be too difficult, in view of tax competition and other factors.[103]

The second argument supports the view that the current international tax regime, based on the OECD Model, is increasingly failing to reduce BEPS, with the bilateral architecture of the OECD Model a significant factor, and that a new international tax regime, based on an MTT, is required. Richard Vann has long doubted the effectiveness of the OECD Model to deal with the sophisticated methods of tax avoidance made possible through a combination of globalisation and technological developments. In his paper entitled 'A Model Tax Treaty for the Asian-Pacific Region', he identified numerous failings of the OECD Model and observed:

> There are three important ways in which the Model is showing its age. It is increasingly inefficient in the sense that it creates biases in economic decisions by firms and governments. It is increasingly irrelevant in the sense that it fails to deal with many emerging problems in the international tax area, and it is increasingly inflexible.[104]

Vann proposed the application of multilateralism to the Asia-Pacific region 'along the lines of the Andean Group and the Nordic Treaty, that is, multilateral treaties within the region and perhaps a joint negotiation of treaties outside the region'.[105] Tax scholars Michael Devereau and John Vella of Oxford University also investigated the shortcomings of the current international corporate tax regime to identify how to refine the existing OECD Model-based regime to reduce BEPS. They suggested that 'rather than propping up the existing system, there is a need to reconsider the fundamental structure of the system', but they did not suggest how this could be achieved.[106]

Diane Ring of Boston College Law School is another author who believes the problems with the OECD Model can only be rectified by an MTT that introduces a new international tax regime, globally or regionally.[107] Ring acknowledged that any attempt at tax harmonisation via a multilateral model tax treaty is over-ambitious and suggested starting with a multilateral model that only addresses the major problems with the OECD Model.[108] In support of her arguments, she cited Victor Thuronyi's work on tax harmonisation and multilateral tax treaties.[109] Sunita Jogarajan of the Melbourne Law School was of a similar view on the

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[103] Brauner (n 24).

[104] Vann (n 4) 99–111.

[105] Ibid 48.

[106] Devereux and Sorensen (n 96) 449–475.

[107] Diane Ring, 'Prospects for A Multilateral Tax Treaty' (2001) 26(4) *Brooklyn Journal of International Law* 1699-1710.

[108] Ibid 1699–1709.

[109] Thuronyi (n 47).

difficulties associated with concluding an MTT but considered South Asian Association for Regional Cooperation ('SAARC') well advanced in this direction and set a precedent for tax multilateralism.[110] Vann and Avi-Yonah shared views consistent with Ring's approach.

Multilateralism is foreign to tax policy but has long played a key role in global trade. An example of nations reaching an agreement when the right conditions prevail is demonstrated by the existence of the World Trade Organization ('WTO') and the GATT, which was a multilateral agreement regulating international trade, replaced by the WTO in 1995, that still exists as the WTO's umbrella treaty for trade in goods.[111] There are several examples of successful multilateral tax treaties currently in existence:

- the Andean Community Income Tax Convention of 2005 between four South American countries[112]
- the Helsinki Treaty of Co-Operation between five Nordic countries[113]
- the South Asian Limited Multilateral Agreement, signed by the eight members of the SAARC.[114]

These treaties are regional and might work because of the relative homogeneity between the countries involved. Although the relative success of these treaties may not be readily applicable in a broader context, they do, however, provide support for an argument for a multilateral treaty.

The evaluative literature on multilateral treaties commences with an examination of the applicable principles of international law embodied in the *Charter of the United Nations*,[115] such as the *principles of the equal rights and self-determination of peoples* and *the sovereign equality and independence of all States.* The *Charter* confirms the Westphalian principle of countries' sovereignty and confirms their unrestricted right to legislate within their borders. The *Vienna Convention on the Law of Treaties* (with annex), concluded at Vienna on 23 May 1969, codifies the law of treaties and affirms that the rules of customary international law govern questions not related to the Vienna Convention. Articles 40, 41, 55, 58, 64 and 66 of the Convention contain the law dealing specifically with multilateral treaties and the amendment of treaties and multilateral treaties.

The deficiencies of the OECD Model have motivated an increasing number of prominent commentators, including Lang, Pinto, Thuronyi, Vann, and Ring quoted above, to suggest the development of an MTT.

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[110] Jogarajan (n 73).

[111] 'Who We Are', *World Trade Organisation* (Web Page) <https://www.wto.org/english/thewto_e/whatis_e/who_we_are_e.htm>.

[112] *Andean Community Income and Capital Tax Convention 2004* (English Translation) <http://internationaltaxtreaty.com/download/bolivia/dtc/Andean%20Community-DTC-May-2004.pdf>.

[113] *Treaty of Co-operation between Denmark, Finland, Iceland, Norway and Sweden* ('the Helsinki Treaty') <http://www.norden.org/en/om-samarbejdet-1/nordic-agreements/treaties-and-agreements/basic-agreement/the-helsinki-treaty>.

[114] SAARC, 'Limited Multilateral Agreement on Avoidance of Double Taxation and Mutual Administrative Assistance in Tax Matters' <https://www.mcgill.ca/tax-law/files/tax-law/SAARC_Treay.pdf>.

[115] *Charter of the United Nations*.

This concept of a multilateral treaty as the means for reducing BEPS, it will be argued, is sound but may be difficult to achieve. Firstly, who will develop the treaty? The OECD has the best credentials but represents only 28 countries. However, during negotiations for the development of the multilateral instrument, the OECD managed to obtain support from a substantial number of disparate tax jurisdictions. The United Nations has its own over-burdened agenda, and the WTO may lack the necessary experience. The cooperation between countries and the OECD on the development of the Action 15 instrument may indicate that fiscal constraints exacerbated by BEPS provide a strong incentive for governments to cooperate to reduce BEPS.

In 2018, Avi-Yonah and Xu analysed the multilateral instrument developed pursuant to Action 15 and its limits and concluded that it would expose both tax jurisdiction and taxpayers to increasing complexity and uncertainty because of its opt-out provisions.[116] Morley observed in 2019 that the MLI would have a limited direct impact on Base Erosion and Profit Shifting.[117] Cooper assessed the multilateral instrument (he described this document as a multilateral treaty) in 2019 and described it as '…probably the most complicated and annoying amending document ever created'.[118]

In 2018, Avi-Yonah and Xu carried out an 'in-depth' examination of the MLI and found the instrument very complicated and also uncertain because of the options available.[119] Also in 2018, Kleist investigated complexity and uncertainty and found both present in the MLI.[120]

It is arguable that the MLI may eventually operate as a bridge between the current bilateral tax treaty regime and a future MTT. Many academic papers have dealt with the recognition by the academic world, as well as in practice, of the increasing need for an MTT.[121]

On 20 December 2021, the OECD published detailed rules to assist in the implementation of what the OECD believes is a landmark reform to the international tax system, ensuring MNEs will be subject to a minimum 15% tax rate from 2023. The OECD's 'Pillar Two model rules' provide governments of

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[116] Reuven Avi-Yonah and Haiyan Xu, 'A Global Treaty Override? The New OECD Multilateral Tax Instrument and its Limits' (2018) 39 *Michigan Journal of International Law* 155.

[117] Joseph Morley, 'Why the MLI will have Limited Direct Impact on Base Erosion and Profit Shifting' (2019) 39(2) *Northwestern Journal of International Law & Business* 225.

[118] Graeme Cooper, 'The MLI – Australia's other income tax treaty' (Paper presented at Perth) (22-23 August 2019) 4.

[119] Avi-Yonah and Xu (n 116).

[120] David Kleist, 'The Multilateral Convention to Implement Tax Treaty Related Measures to prevent BEPS – Some Thoughts on complexity and Uncertainty' (2018) 1 *Nordic Tax Journal* 31–48.

[121] See, eg, Kim Brooks, 'The Potential of Multilateral Tax Treaties, in Tax Treaties: Building Bridges Between Law and Economics' in Michael Lang et al (eds) *Tax Treaties: Building Bridges Between Law and Economics* (IBFD, 2010); Junghong Kim, 'A New Age of Multilateralism in International Taxation?' (2015) 21 *Seoul Tax Law Review* 227; Richard L. Reinhold, 'Some Things That Multilateral Tax Treaties Might Usefully Do' (2004) 57 *Tax Law* 661; Thomas Rixen, 'Bilateralism or Multilateralism? The Political Economy of Avoiding International Double Taxation' (2010) 16 *European Journal of International Relations* 589; Thuronyi (n 47); Vann (n 4).

developed tax jurisdictions with a means to prevent developing countries from attracting MNEs to lower tax jurisdictions.

The rules define the scope and set out the mechanism for the so-called 'Global Anti-Base Erosion ('GloBE') rules' under Pillar Two, which will introduce a global minimum corporate tax rate set at 15%. The minimum tax will apply to MNEs with revenue above EUR 750 million and is estimated to generate around USD 150 billion in additional global tax revenues annually. The GloBE rules provide for a coordinated system of taxation intended to ensure large MNE groups pay this minimum level of tax on income arising in each of the jurisdictions in which they operate. The rules create a 'top-up tax' to be applied on profits in any jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum 15% rate. The new Pillar Two model rules will assist countries with introducing the GloBE rules into domestic legislation in 2022. They provide for a coordinated system of interlocking rules that:

- define the MNEs within the scope of the minimum tax;
- set out a mechanism for calculating an MNE's effective tax rate on a jurisdictional basis and for determining the amount of top-up tax payable under the rules; and
- impose the top-up tax on a member of the MNE group in accordance with an agreed rule order.[122]

In early 2022, the OECD released the Commentary relating to the model rules and addressed co-existence with the US Global Intangible Low-Taxed Income rules. This will be followed by the development of an implementation framework focused on administrative, compliance and coordination issues relating to Pillar Two. The Inclusive Framework also developed the model provision for a Subject to Tax Rule, together with a multilateral instrument for its implementation, which was released in the early part of 2022. A public consultation event on the implementation framework was held in February 2022 and on the Subject to Tax Rule in March 2022.[123] This is more fully examined in Chapter 2.

Chapter 2 investigates the current international tax regime.

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[122] 'OECD releases Pillar Two model rules for domestic implementation of 15% global minimum tax' *OECD* (Web Page, 20 December 2021) <https://www.oecd.org/tax/beps/oecd-releases-pillar-two-model-rules-for-domestic-implementation-of-15-percent-global-minimum-tax.htm>

[123] Ibid.

CHAPTER 2: THE CURRENT INTERNATIONAL TAXATION REGIME

2.1 Introduction

This chapter briefly analyses the current international taxation regime to identify certain fundamental historical concepts that provide the foundation upon which the current tax regime is based. The chapter then examines the overlying effect of the proliferation of multinationals, globalisation, and the digital economy upon existing domestic and international tax laws and internationally agreed standards. The research argues that the increasing interaction of the current domestic tax systems, resulting from globalisation, provides expanding opportunities for multinationals to minimise tax in ways that are inconsistent with the policy objectives of jurisdictional tax laws and international standards. The research conducted in this chapter includes that undertaken to obtain evidence of tax avoidance practices by multinationals.

For the purposes of this research, the OECD's working definition of 'tax' has been adopted. Under this definition, 'Tax is a compulsory, unrequited payment to the government'.[124] This definition is used because the OECD occupies a pivotal role in international taxation and is intrinsically involved in developing ongoing programs designed to reduce base erosion and profit shifting, with which this research is concerned.

Treaties are agreements between sovereign nations. Article 2 of the *Vienna Convention on the Law of Treaties,* which applies to all treaties, provides: 'A treaty is an international agreement (in one or more instruments, whatever called) concluded between States and governed by international law'.[125] The first agreement between countries that was solely a tax treaty was concluded by Russia and Saxony in 1786.[126] The current international tax regime consists of over 3,500 bilateral tax treaties. These tax treaties confer rights and impose obligations on the two contracting countries but not on third parties, such as taxpayers. In some countries, treaties are self-executing: that is, once the treaty is concluded, it confers rights on the residents of the contracting countries. In other countries, some additional action is necessary (for example, the treaty provisions must be enacted into domestic law) before benefits under a treaty are accessible to residents of the contracting countries.[127]

Early tax treaties were aimed at assisting international trade by addressing double taxation and other tax barriers to international trade. A concerted effort to develop a model tax treaty was first undertaken by the League of Nations, which was formed on 10 January 1920, following the Paris Peace Conference that ended the First World War.[128] Following the First World War, the League worked on developing a model double

[124] 'Explanatory Statement' (n 7).

[125] *Vienna Convention* (n 34).

[126] Andrey Savitskil, 'Tax in History: In search of Origins' (2021) 49(6/7) *Intertax* 569–585.

[127] Brian J. Arnold, 'An Introduction to Tax Treaties' (United Nations, 2015) <http://www.un.org/esa/ffd/wp-content/uploads/2015/10/TT_Introduction_Eng.pdf>.

[128] Christian Tomuschat, *The United Nations at Age Fifty: A Legal Perspective* (Martinus Nijhoff Publishers, 1995) 77.

taxation treaty. As a part of this program, the League's Economic and Financial Commission appointed four experts on double taxation (Professors M. Bruins, Netherlands; M. Epinaoi, Italy; E.R.A. Seligman, United States; and Sir Josiah Stamp, United Kingdom) to prepare a report on double taxation. The terms of reference sought to identify the economic consequences of double taxation and find a solution to the problem of double taxation either within the then-existing international taxation arrangements or by international convention or amendment of the domestic taxation laws of individual countries.

The four economists submitted their report to the League of Nations' Economic and Financial Commission, proposing the following questions for the determination of economic allegiance:

- Where is the yield physically or economically produced?
- Where are the results of the process as a complete production of wealth actually to be found?
- Where can the rights to the handing-over of these results be enforced?
- Where is the wealth spent, consumed, or otherwise disposed of?

The report of the four economists then identified four possible ways in which double taxation could be prevented:

1. The first was an unlimited foreign tax credit, as originally applied in the United States.
2. The second was an exemption by the country of origin of all income of non-residents.
3. The third was a system like the Dominion Income Tax Relief system operated by Britain, which divided the tax and allocated the relief given between the two states.
4. The fourth was the division of sources of income between the two countries so that each country taxed the sources of income assigned to it.[129]

Although the four economists noted advantages and disadvantages of each of these methods,[130] their report[131] formed the basis of the first draft model double tax agreement, published in 1928.[132] This model favoured the allocation of taxing rights on international transactions to a taxpayer's country of residence.[133]

The League of Nations established a Fiscal Committee in 1929 to consider further developments of the model. In his 2014 book *International Tax Policy and Double Tax Treaties,* Professor Holmes proposed that this was because the 1928 model was narrow in scope.[134] The Fiscal Committee continued working on the issue of further development of the model that resulted in regional conferences held in Mexico City in 1940

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[129] League of Nations, Technical Experts, *Double Taxation and Tax Evasion: Report and Resolutions Submitted by the Technical Experts to the Financial Committee of the League of Nations* (League of Nations Doc F.212, 7 February 1925)

[130] Ibid.

[131] League of Nations, Economic and Financial Council, *Double Taxation and Tax Evasion* (October 1928) 41.

[132] Kevin Holmes, *International Tax Policy and Double Tax Treaties* (IBFD, 2014) 61.

[133] Ibid.

[134] Ibid.

and 1943 and attended by the representatives of North and South American countries. A new draft Double Tax Agreement, commonly known as the 'Mexico Draft', resulted from these conferences.[135]

Holmes noted that the primary taxing jurisdiction was to be the state of the source of income, a position advantageous to developing countries.[136] The Mexico Draft was subsequently reviewed in London in 1946, changing the underlying basis of taxing international transactions back to taxpayers' state of residence rather than the state of the source of income or, in other words, the state where the economic activity occurred.[137] Between 1946 and 1955, over 70 bilateral double tax agreements were signed by various countries.[138] The United Nations succeeded the League of Nations in 1945 and the role in developing the model tax treaty passed to the Organization for European Economic Cooperation ('OEEC') in 1948. The Convention transforming the OEEC into the OECD was signed at the Chateau de la Muette in Paris on 14 December 1960 and entered into force on 30 September 1961.[139]

The current network of around 3,500 tax treaties is based mainly on the OECD *Model Tax Convention on Income and on Capital* ('OECD Model'), which was published in 1977.[140] The full version of the OECD Model includes the Commentaries on the OECD Model.[141] The United Nations also developed a bilateral model tax treaty, the *Model Double Taxation Convention* ('UN Model'), first published in 1980.[142] To avoid confusion between the two Models, the thesis refers to the OECD Model and the UN Model throughout.

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[135] Ibid.

[136] Ibid.

[137] Ibid.

[138] Ibid.

[139] '60 Years', *OECD* (Web Page) <https://www.oecd.org/60-years/>.

[140] *Model Tax Convention 2014* (n 9). The Model contains 31 Articles and was updated in 1994,1995, 1997, 2000, 2003, 2005,2008,2010, and 2014 with the next update due in 2017. There are 379 pages of Commentaries on the Articles of the Model Convention available at: http://www.oecd.org/berlin/publikationen/43324465.pdf.

[141] Ibid.

[142] United Nations, *Model Double Taxation Convention 2011* (United Nations, 2011) vi <http://www.un.org/esa/ffd/documents/UN_Model_2011_'Update.pdf>.

Whilst the United Nations model is based on the OECD Model, there are significant variations.

'2. These Models, particularly the *United Nations Model Double Taxation Convention* and the *OECD Model Tax Convention on Income and on Capital* (the OECD Model Convention) have had a profound influence on international treaty practice and have significant common provisions. The similarities between these two leading Models reflect the importance of achieving consistency where possible. On the other hand, the important areas of divergence exemplify, and allow a close focus upon, some key differences in approach or emphasis as exemplified in country practice. Such differences relate, in particular, to the issue of how far one country or the other should forego, under a bilateral tax treaty, taxing rights that would be available to it under domestic law, with a view to avoiding double taxation and encouraging investment.

3. The United Nations Model Convention generally favours retention of greater so-called "source country" taxing rights under a tax treaty—the taxation rights of the host country of investment—as compared to those of the "residence country" of the investor. This has long been regarded as an issue of special significance to developing countries, although it is a position that some developed countries also seek in their bilateral treaties.

The OECD represents 38 of the world's developed economies and is at the forefront of efforts to reduce BEPS but is not recognised as the world taxing authority. The OECD's website describes the OECD in its 'About – Who we are' section as follows:

> The Organisation for Economic Co-operation and Development (OECD) is an international organisation that works to build better policies for better lives. Our goal is to shape policies that foster prosperity, equality, opportunity, and well-being for all. We draw on 60 years of experience and insights to better prepare the world of tomorrow.
>
> Together with governments, policy makers and citizens, we work on establishing evidence-based international standards and finding solutions to a range of social, economic, and environmental challenges. From improving economic performance and creating jobs to fostering strong education and fighting international tax evasion, we provide a unique forum and knowledge hub for data and analysis, exchange of experiences, best-practice sharing, and advice on public policies and international standard-setting.[143]

The OECD Mission Statement describes the current role of the OECD as providing a forum in which governments can work together to share experiences and seek solutions to common problems. The Mission Statement lays claim to analysing and comparing data to predict future trends and set international standards in, inter alia, taxation.[144]

Professor Pinto made the following observations on the role of the OECD in 2002:

> Amongst all the studies and reports that make up the literature which deals with electronic commerce, the international debate in respect of the taxation issues arising from electronic commerce is largely driven by the OECD's Committee on Fiscal Affairs ('CFA') which has assumed a lead role in the process as developed countries have generally agreed that the OECD is the most appropriate forum for the tax policy issues to be taken forward. At the same time, there is no universal consensus as to the OECD's lead role in these matters, as many believe that it principally represents the interests of the developed countries that make up its constituency. Also, others contend that the OECD is not as inclusive as other forums (such as the WTO) and is therefore limited in being able to secure international consensus on the tax issues relating to electronic commerce. Nevertheless, the reality is that currently the primary form of tax coordination among countries is carried out by the OECD's CFA, as supported by the activities of its various Working Parties.[145]

In 2013, the OECD published *Addressing Base Erosion and Profit Shifting,* a report that expressed concern that base erosion 'constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for OECD member countries and non-members alike'.[146] Whilst the OECD estimated in 2013 that base erosion and profit shifting costs governments between US$100–240 billion per annum, or anywhere from 4–10% of

[143] 'About', *OECD* (Web Page) <https://www.oecd.org/about/>.

[144] 'Our Mission', *OECD* (Web Page, 3 November 2016) <http://www.oecd.org/about/>.

[145] Pinto 'The Continued Application of Source-Based Taxation' (n 74).

[146] *Addressing Base Erosion and Profit Shifting* (n 23).

global corporate income ('CIT') revenues,[147] it is very difficult to produce precise numbers because of the vast number of variables involved in this exercise.

Following up on the issue of BEPS the OECD published an Action Plan in 2013 and in 2015 published a series of Final Reports that were widely expected to successfully reduce the incidence of BEPS. These will be examined in more detail elsewhere in the thesis.

2.2 Tax Sovereignty and Jurisdiction to Tax

For many centuries, the concept of sovereignty has been of considerable importance to rulers and citizens alike. Between May and October 1648, following the end of the Thirty Years' War, the countries involved in the conflict conducted a series of negotiations in the Westphalian cities of Osnabrück and Münster. These negotiations resulted in a series of peace treaties that produced a concept of peaceful co-existence between sovereign countries based on the concept of territorial sovereignty. They also confirmed the political theory of non-interference by one country in the affairs of other countries, which became known as Westphalian sovereignty.[148] The concept of Westphalian sovereignty is generally accepted to include the principle that each country has the unfettered right to make its own laws, including tax laws.

The political theory of Westphalian sovereignty is now formally recognised in Articles 1 and 2, Chapter 1 of the *Charter of the United Nations*.[149]

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[147] OECD, 'Tackling Tax Avoidance – Implementing the BEPS Measures: Summary' (OECD Conference Centre, Paris,

2 May 2016) <https://www.oecd.org/parliamentarians/meetings/groupontax-may2016/Summary-parliamentary-group-on-tax-2 May 2016.pdf>.

[148] Stephane Beaulac, 'The Westphalian Model in Defining International Law: Challenging the Myth' (2004) 9 *Australian Journal of Legal History* 1.

[149] *Charter of the United Nations*. See for example, Article 1:

The Purposes of the United Nations are:

1. *To maintain international peace and security, and to that end: to take effective collective measures for the prevention and removal of threats to the peace, and for the suppression of acts of aggression or other breaches of the peace, and to bring about by peaceful means, and in conformity with the principles of justice and international law, adjustment or settlement of international disputes or situations which might lead to a breach of the peace*.
2. To develop friendly relations among nations based on respect for the principle of equal rights and self-determination of peoples, and to take other appropriate measures to strengthen universal peace.
3. To achieve international co-operation in solving international problems of an economic, social, cultural, or humanitarian character, and in promoting and encouraging respect for human rights and for fundamental freedoms for all without distinction as to race, sex, language, or religion; and
4. To be a centre for harmonizing the actions of nations in the attainment of these common ends.

See also Article 2

The Organisation and its Members, in pursuit of the Purposes stated in Article 1, shall act in accordance with the following Principles.

1. The Organization is based on the principle of the sovereign equality of all its members.

2.3 Tax Harmonisation

'Tax harmonisation' is an expression that describes a system of taxation in which identical or similar taxes are imposed by countries within a region. In practice, this would usually require countries with lower tax rates to increase tax rates. A good example is the EU, where all countries must have a value-added tax of at least 15%.[150]

The most notable example of an attempt at tax harmonisation is provided by the European Commission's proposal in 2011 for a Common Consolidated Corporate Tax Base ('CCCTB').[151] The EC proposed the CCCTB as a single set of rules to be applied by multinationals to calculate their taxable profits in the EU, instead of dealing separately with the different national tax systems of the EU countries. The EC argued that the CCCTB has advantages for multinationals, such as reduced compliance costs and less uncertainty. It was also designed to significantly help combat tax avoidance in the EU.[152] *The Treaty on the Functioning of the EU* contains specific provisions regarding taxation, which are contained in Articles 110 to 113 of the *Treaty*.[153]

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2. All Members, in order to ensure to all of them the rights and benefits resulting from membership, shall fulfil in good faith the obligations assumed by them in accordance with the present Charter.
3. *All Members shall settle their international disputes by peaceful means in such a manner that international peace and security, and justice, are not endangered.*
4. All Members shall refrain in their international relations from the threat or use of force against the territorial integrity or political independence of any state, or in any other manner inconsistent with the Purposes of the United Nations.
5. All Members shall give the United Nations every assistance in any action it takes in accordance with the present Charter and shall refrain from giving assistance to any state against which the United Nations is taking preventive or enforcement action.
6. The Organisation shall ensure that states which are not Members of the United Nations act in accordance with these Principles so far as may be necessary for the maintenance of international peace and security.
7. Nothing contained in the present Charter shall authorize the United Nations to intervene in matters which are essentially within the domestic jurisdiction of any state or shall require the Members to submit such matters to settlement under the present Charter; but this principle shall not prejudice the application of enforcement measures under Chapter Vll.

[150] 'The EU's Common System of Value Added Tax (VAT)' *EUR-Lex* (Web Page, 21 October 2021) <http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=URISERV%3Al31057>.

'The standard rate of VAT to be applied by all EU countries to goods and services is no less than 15 %. EU countries may apply 1 or 2 reduced rates of no less than 5 % to specific goods or services listed in Annex III to the Directive. A number of provisions which derogate from these rules (lower rates, reduced rates on other goods or services, etc.) also apply under certain conditions.'

[151] 'Common Consolidated Corporate Tax Base (CCCTB)', Taxation and Customs Union, European Commission (Web Page, 3 December 2016) <http://ec.europa.eu/taxation_customs/business/company-tax/common-consolidated-corporate-tax-base-ccctb_en>.

[152] Ibid.

[153] 'Tax Harmonisation', *EUR-Lex* (Web Page, 29 December 2016) <http://eur-lex.europa.eu/summary/glossary/tax_harmonisation.html>.

Tax Provisions

Most EU members did not greet the CCCTB proposal with much enthusiasm, and it was left in abeyance. A 2014 Working Paper by Antonio Simões, Jose Ventura and Luis Coelho of Evora University analysed the relationship between fiscal harmonisation and Foreign Direct Investment.[154] Simões et al's literature review revealed that some papers examined advocated harmonising corporate tax within the EU, while others advocated that competition between countries creates a better environment for attracting investment. Simões et al relied upon Afonso's 1999 paper for evidence that 'European fiscal regimes with a heavier tax burden for companies offer a qualified workforce and a stable climate favorable to creating business and adds that fiscal harmonisation regarding corporate tax has negative effects on the process of EU convergence'.[155]

Simões et al also relied upon Mitchell's 2002 paper as providing authority for the proposition 'that fiscal competition leads to a reduction in tax rates and that increased mobility of capital occurs when investors can easily move investment to countries with a lower tax burden'.[156] Finally, Simões et al concluded 'that fiscal competition is a very important factor in stimulating the free movement of capital'.[157]

Article 110

No Member State shall impose, directly or indirectly, on the products of other Member States any internal taxation of any kind in excess of that imposed directly or indirectly on similar domestic products.

Furthermore, no Member State shall impose on the products of other Member States any internal taxation of such a nature as to afford indirect protection to other products.

Article 111

Where products are exported to the territory of any Member State, any repayment of internal taxation shall not exceed the internal taxation imposed on them whether directly or indirectly.

Article 112

In the case of charges other than turnover taxes, excise duties and other forms of indirect taxation, remissions and repayments in respect of exports to other Member States may not be granted and countervailing charges in respect of imports from Member States may not be imposed unless the measures contemplated have been previously approved for a limited period by the Council on a proposal from the Commission.

Article 113

The Council shall, acting unanimously in accordance with a special legislative procedure and after consulting the European Parliament and the Economic and Social Committee, adopt provisions for the harmonisation of legislation concerning turnover taxes, excise duties and other forms of indirect taxation to the extent that such harmonisation is necessary to ensure the establishment and the functioning of the internal market and to avoid distortion of competition.

[154] António Jacinto Simões, José Ventura and Luís A. G. Coelho, 'Foreign Direct Investment and Fiscal Policy - A Literature Survey' (CEFAGE-UE Working Papers No 11, University of Evora, 2014).

[155] Antonio Afonso, 'Ricardian Fiscal regimes in the European Union' (Working Paper Series No 558, European Central Bank, November 2005) <https://papers.ssrn.com/sol3/papers.cfm?abstract_id=850945>.

[156] Simões et al (n 154).

[157] Ibid.

On 17 June 2015, the EC presented a strategy to re-launch the CCCTB, known as the Action Plan for Fair and Efficient Corporate Taxation.[158] The Action Plan set out a series of initiatives to tackle tax avoidance, secure sustainable revenues, and strengthen the Single Market for businesses. The EU hoped that collectively these measures would significantly improve the corporate tax environment in the EU, making it fairer, more efficient, and more growth-friendly.[159]

Key actions include a strategy to re-launch the CCCTB and a framework to ensure effective taxation where profits are generated. The Commission also published a first pan-EU list of third-country, non-cooperative tax jurisdictions and launched a public consultation to assess whether companies should have to publicly disclose certain tax information.[160]

In an article published in the *EU Observer* on 17 June 2015, Journalist Honor Mahony suggested that the 2011 proposal had been 'stuck in the legislative pipelines' – to a large extent due to objections from countries such as Ireland and the United Kingdom.[161] Mahony suggested that the political dynamics relating to the introduction of a common consolidated corporate tax base have changed. Mahony reported that 'public anger flared over revelations that large companies avoid tax bills by shifting profits to countries offering low rates or "sweetheart deals"'.[162] Furthermore, the UK has now left the European Union, and Ireland has been ordered by the EC to collect a substantial amount of tax from Apple. Many of the circumstances relevant to the CCCTB are constantly changing.

On 25 October 2016, the EC announced plans to overhaul how companies are taxed in the Single Market and claimed that the result would be a growth-friendly and fair corporate tax system.[163] The corporate reform package proposal published on 25 October 2016 provided three new proposals:

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[158] European Commission, *An Action Plan for Fair and Efficient Corporate Taxation* (EC Publishing, 15 July 2020) <https://ec.europa.eu/taxation_customs/business/company-tax/corporate-tax-reform-package_en>

[159] European Commission, 'Corporate Tax Reform Package' (Press Release, 21 November 2016) <https://europa.eu/rapid/press-release_IP-16-1886_en.htm>.

[160] Ibid.

[161] Honor Mahony, 'EU in new push for common corporate tax base', *EU Observer* (online), 17 June 2015 <https://euobserver.com/economic/129156>.

[162] See, eg, Houlder, Vanessa, 'Poorer countries handed role in tax evasion fight', *Financial Times* (online), 25 February 2016 < https://www.ft.com/stream/ddba2148-4d48-410a-81f6-927651f51cf9?page=15>.

[163] European Commission, 'Commission proposes major corporate tax reform for the EU' (Press Release, 25 October 2016) <http://europa.eu/rapid/press-release_IP-16-3471_en.htm>.

Re-calibrated as part of a broader package of corporate tax reforms, the Common Consolidated Corporate Tax Base (CCCTB) will make it easier and cheaper to do business in the Single Market and will act as a powerful tool against tax avoidance.

Press Release

First tabled in 2011, the CCCTB was designed to strengthen the Single Market for businesses. While Member States made considerable progress on many core elements of the previous CCCTB proposal, they were unable to reach a final agreement. Having sought the views of the Member States, businesses, civil society, and the European Parliament, we are today bolstering the

1. The Commission proposed to re-launch the Common Consolidated Corporate Tax Base (CCCTB). The CCCTB will overhaul the way in which companies are taxed in the Single Market, to ensure a fairer, more competitive and more growth-friendly corporate tax system. The re-launched CCCTB will be implemented in two steps. It also contains important new elements to improve its anti-avoidance and growth-promoting capacities.[164]
2. The Commission has also proposed an improved system to resolve double taxation disputes in the EU. Double taxation is a major obstacle for businesses, creating uncertainty, unnecessary costs, and cash-flow problems. Under the proposal, current dispute resolution mechanisms will be adjusted, to better meet the needs of businesses. In particular, a wider range of cases will be covered, and Member States will have clear deadlines to agree on binding solutions to cases of double taxation.[165]
3. The package also includes a proposal to extend the rules against hybrid mismatches as provided for in the Anti-Tax Avoidance Directive agreed to in June, to hybrid mismatches involving non-EU countries.[166]

There is an even greater focus now on multinationals paying taxes in the countries where economic activity has taken place and profits were generated than in 2013 when the G20/OECD BEPS Project began with the OECD publication *Addressing Base Erosion and Profit Shifting* and the *Action Plan on Base Erosion and Profit Shifting*.

Most countries, particularly those with larger economies, are opposed in principle to tax harmonisation. For a multilateral model tax treaty to gain widespread acceptance, it would need to address the issue of tax harmonisation in a manner acceptable to those countries.

The research to be conducted regarding the development of a multinational model tax treaty by the OECD will not extend to any of the following:

1. Harmonisation of tax rates and structures as this is a complex issue in a globalising world and is not of central importance to the thesis.
2. Restriction of the right of governments to determine tax policies and structures – this is an important area for in-depth examination and is beyond the scope of this thesis.
3. Restriction of legitimate tax planning – this is an area of great importance and has many facets – too many for serious consideration in this thesis.

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pro-business elements of the previous proposal to help cross-border companies cut costs, red tape, and support innovation. The re-launched CCCTB will also create a level-playing field for multinationals in Europe by closing off avenues used for tax avoidance.

Two further proposals aim to improve the current system for dispute resolution on double taxation in the EU and to bolster existing anti-abuse rules. Taken together, these measures will create a simple and pro-business tax environment.

[164] Ibid.

[165] Ibid.

[166] Ibid.

4. Proposing minimum levels of taxation – this is treated where the thesis covers the OECD's Two Pillars proposal.
5. Elimination of commercially useful structures, including holding companies. This is an interesting area but is superfluous to this thesis.

2.4 Recent Developments

2.4.1 Multinational Enterprises and How They Operate

During the 20th century, rapid advances in the speed of travel, telecommunications and the advent of the internet led to a proliferation of global entities, generally known as multinationals, that carry on business in two or more jurisdictions. An MNE is typically a large corporation which produces or sells goods or services in various countries.[167] Multinationals are legal entities that often have their management headquarters in one country, known as the home country, and operate in other countries. Google Inc. and Apple Inc. are good examples of large multinationals that operate in virtually every country. The history of multinationals is closely related to the origins of trade across borders. In recent years, an increasing number of multinationals have declared profits in countries with low corporate tax rates but where little economic activity has occurred. The management of multinationals are accountable to their shareholders, so the issue of low taxation becomes of major importance to the after-tax profits available for distribution to shareholders and expansion, research, and development.

Many multinationals have responded to the changing business environment by changing their operating network.[168] Instead of employing an operating model that allows multinationals to replicate their business functions in each jurisdiction where they have a business presence, multinationals now seek to adopt a global value chain, with business functions located where they can be efficiently undertaken both cost-wise and operationally, for the enterprise. This has resulted in a shift from domestic to global operating models, which means labour-intensive operations are based in countries with low wages and operating costs. Similarly, intellectual property rights are registered in countries with low corporate taxation rates to minimise corporate income tax. Ireland is one example.[169]

Consequently, multinationals tend to operate as a single economic entity rather than as a group of related but separate entities. This enables them to manage the various components of their operations within their multinational networks and thereby take advantage of fluctuations in demand, costing, and other conditions to best coordinate production and distribution across many countries.[170] This is further expedited by

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[167] Christopher M. Doob, *Social Inequality and Social Stratification in US Society* (Pearson Education Inc., 2013).

[168] See, eg, Christos Pitelis and Roger Sugden, *The Nature of the Transnational Firm* (Routledge, 2nd Edition, 2000) 7.

[169] 'Global Value Chains (GVCs), *OECD* (Web Page) <https://www.oecd.org/sti/ind/global-value-chains.htm>.

[170] OECD, World Trade Organisation and World Bank Group, *Global Value Chains: Challenges,Opportunities, and Implications for Policy* (Report prepared for submission to the G20 Trade Ministers Meeting Sydney, Australia, 19 July 2014).

electronic commerce and rewarded through tax competition. One rationale for multilateral tax treaties is based on the premise that this increasingly multilateral way in which multinationals operate is inconsistent with the current bilateral double tax treaty network, well designed for a past era but now increasingly irrelevant and, as such, increasingly facilitating base erosion and profit shifting.

It will also be proposed in later chapters that preserving and modifying the current bilateral tax treaty network is unlikely to curtail BEPS. In contrast, multilateral treaties based on a multilateral model tax treaty developed by the OECD could theoretically provide a multilateral solution to a multilateral problem and, consequently, address BEPS more effectively than the current bilateral tax treaty network. Work currently being undertaken by the OECD with respect to the BEPS Action Plan provides a well-developed foundation and ideal political environment for the OECD to take the next step and develop a multilateral model tax treaty.

Tax is imposed under domestic laws. If a corporation complies with the domestic laws but this results in the erosion of a government's tax base, then that is a lawful outcome, provided company directors and advisors have performed their duties in compliance with the relevant laws. The position with corporations is that generally their management is legally obliged to manage the business to prevent insolvent trading. In Australia, the provisions of the *Corporations Act 2001* and the activities of the Australian Securities and Investment Commission oversee the functioning of the corporate sector. The liability of directors of Australian registered corporations is dealt with in Section 558G of the *Corporations Act 2001*.[171]

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[171] *Corporations Act 2001* (Cth).

Director's duty to prevent insolvent trading by company:

(1) This section applies if:

(a) a person is a director of a company at the time when the company incurs a debt; and

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and

(c) at that time, there are reasonable grounds for suspecting that the company is insolvent, or would so become insolvent, as the case may be; and

(d) that time is at or after the commencement of this Act.

(1A) For the purposes of this section, if a company takes action set out in column 2 of the following table, it incurs a debt at the time set out in column 3.

(2) By failing to prevent the company from incurring the debt, the person contravenes this section if:

(a) the person is aware at that time that there are such grounds for so suspecting; or

(b) a reasonable person in a like position in a company in the company's circumstances would be so aware.

Note: This subsection is a civil penalty provision (see subsection 1317E (1)).

(3) A person commits an offence if:

(a) a company incurs a debt at a particular time; and

It can be argued that this duty extends to taking advantage of deficiencies or discrepancies in domestic tax laws to minimise taxation liability and maximise profits. The directors of multinationals are generally accountable to the shareholders for the decisions taken regarding tax issues and not to the government, provided they comply with the relevant tax laws.

An example of base erosion and profit shifting, alleged by the European Commission to have occurred in Ireland as the result of two Irish tax rulings in 1991 and 2007, became public knowledge on 30 August 2016, when the European Commission issued a press release under the banner: '*State aid: Ireland gave illegal tax benefits to Apple worth up to €13 billion'*.[172] The press release alleged that Ireland granted 'illegal tax benefits' that allowed Apple to 'pay an effective corporate tax rate of 1 per cent on its European profits in 2003, down to 0.005 per cent in 2014'.[173] The press release alleged that this result was achieved through two Irish tax rulings in 1991 and 2007, which resulted in only a small percentage of the profits of Apple Sales International and Apple Operations Europe, the two Apple corporations trading in Europe, being taxed in Ireland, while the rest was taxed nowhere.[174]

2.4.2 Globalisation

For the purposes of the research to be conducted, which generally is concerned with the period from 1977 to the present, globalisation is defined as 'the process of international integration arising from the interchange of world views, products, ideas, and other aspects of culture'.[175] These four decades have produced the rapid

(aa) at that time, a person is a director of the company; and

(b) the company is insolvent at that time, or becomes insolvent by incurring that debt, or by incurring at that time debts including that debt; and

(c) the person suspected at the time when the company incurred the debt that the company was insolvent or would become insolvent as a result of incurring that debt or other debts (as in paragraph (1)(b)); and

(d) the person's failure to prevent the company incurring the debt was dishonest.

(3A) For the purposes of an offence based on subsection (3), absolute liability applies to paragraph (3)(a).

[172] European Commission, 'State aid: Ireland gave illegal tax benefits to apple worth up to €13 billion' (Press Release, 30 August 2016).

[173] Ibid.

[174] Ibid. A disproportionate number of multinationals have their intellectual property registered in Ireland where they pay a low rate of tax.

'The European Commission has concluded that Ireland granted undue tax benefits of up to €13 billion to Apple. This is illegal under EU state aid rules because it allowed Apple to pay substantially less tax than other businesses. Ireland must now recover the illegal aid.

Commissioner Margrethe Vestager, in charge of competition policy, said: "Member States cannot give tax benefits to selected companies – this is illegal under EU state aid rules. The Commission's investigation concluded that Ireland granted illegal tax benefits to Apple, which enabled it to pay substantially less tax than other businesses over many years. In fact, this selective treatment allowed Apple to pay an effective corporate tax rate of 1 per cent on its European profits in 2003 down to 0.005 per cent in 2014.'

[175] Martin Albrow and Elizabeth King (eds), *Globalization, Knowledge, and Society* (Sage Publications, 1990).

globalisation of economic activity, substantially impacting how international business is conducted and changing the framework of the world economy. Rao proposes that globalisation produces an efficient allocation of resources across borders and generates higher productivity, increased competition, lower prices, and increased product variety and quality.[176]

In the introduction to Chapter 1 of the BEPS Action Plan, the OECD made the following comments concerning globalisation:

> Globalisation is not new, but the pace of integration of national economies and markets has increased substantially in recent years. The free movement of capital and labour, the shift of manufacturing bases from high-cost to low-cost locations, the gradual removal of trade barriers, technological and telecommunication developments, and the ever-increasing importance of managing risks and of developing, protecting, and exploiting intellectual property have had an important impact on the way cross-border activities take place. Globalisation has boosted trade and increased foreign direct investments in many countries. Hence it supports growth, creates jobs, fosters innovation, and has lifted millions out of poverty.[177]

The causes of globalisation are many and include the increasing ease of international transport and the advent of the internet with an instantaneous availability of images and information on a plethora of topics. This abundance of information and avenues for electronically disseminating this information has enabled the free movement of capital and the relocation of industries based on increasing profits and reducing tax.

In 2000, the International Monetary Fund ('IMF') identified four basic aspects of globalisation:

1. trade and transactions
2. capital and investment movements
3. migration and movement of people
4. the dissemination of knowledge.

The IMF also defined the term 'globalisation' as referring to the increasing integration of economies around the world, particularly through trade and financial flows.[178] The OECD identifies globalisation as a cause of less revenue for governments due to lower tax rates and higher compliance costs.[179]

Another important facilitator of trade 'globalisation' is the WTO, established on 1 January 1995 to succeed the GATT, which was operational from 1947. Most of the work currently undertaken by the WTO results

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[176] Andy Rao, '4 Positive impacts of globalization on world economy' *The Collegian* (online), 7 May 2013.

<http://www.kstatecollegian.com/2013/05/07/4-positive-impacts-of-globalization-on-world-economy/>.

[177] OECD, *Action Plan on Base Erosion and Profit Shifting* (n 25) 7.

[178] International Monetary Fund, 'Globalization: Threat or Opportunity?' (Issue Brief 00/01, 12 April 2000) <https://www.imf.org/external/np/exr/ib/2000/041200to.htm#II>.

[179] *Addressing Base Erosion and Profit Shifting* (n 23) 25.

from GATT negotiations conducted between 1986 and 1994.[180] The WTO website explains that the purpose of the WTO is to simplify and assist global trade. The WTO creates and operates an effective system for international commerce by consenting member states based on legal ground rules that include effective dispute resolution.[181]

2.4.3 The Digital Economy

The BEPS Action Plan recognises that the spread of the digital economy also creates challenges for international taxation:

> The digital economy is characterised by an unparalleled reliance on intangible assets, the massive use of data (notably personal data), the widespread adoption of multi-sided business models capturing value from externalities generated by free products, and the difficulty of determining the jurisdiction in which value creation occurs. This raises fundamental questions as to how enterprises in the digital economy add value and make their profits and how the digital economy relates to the concepts of source and residence or the characterisation of income for tax purposes. At the same time, the fact that new ways of doing business may result in a relocation of core business functions and, consequently, a different distribution of taxing rights which may lead to low taxation is not per se an indicator of defects in the existing system. It is important to examine closely how enterprises of the digital economy add value and make their profits, to determine whether and to what extent it may be necessary to adapt the current rules to properly consider the specific features of that industry and to prevent BEPS.[182]

Professor Pinto identifies the following six areas of concern that have been enhanced by the digital economy:

1. *Mobility of intangibles, users, and business functions*. Pinto identifies the development and exploitation of intangibles as core contributors to value creation and economic growth for companies and, as such, a key characteristic of the digital economy.[183]
2. *Reliance on data*. This includes 'the massive use of data, which has been facilitated by an increase in computing power and storage capacity which has been accompanied by a corresponding decrease in data storage cost'.[184]
3. *Network effects*. This refers to the relationship between users.[185]

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180 'Who We Are', *World Trade Organization* (Web Page, 31 December 2016) <https://www.wto.org/english/thewto_e/whatis_e/who_we_are_e.htm>.

181 Ibid.

182 *Action Plan on Base Erosion and Profit Shifting* (n 25).

183 Pinto, 'The Continued Application of Source-Based Taxation' (n 74).

184 Ibid.

185 Ibid.

4. *Multi-sided business models*. This refers to business models extending to more than one jurisdiction and was investigated by Zaheer et al in 2019.[186]
5. *Monopoly or oligopoly*. A tendency apparent in business models that rely heavily on network effects.[187]
6. *Volatility*. This is due to low entry barriers and rapidly evolving technology.[188]

Pinto adopts the view that the digital economy does not represent any great departure from past business models but is more a reflection of the advances in information and communication technologies.[189] He submits that the digital economy is a part of the general economy and should not be treated differently for tax purposes.

In January 2013, the French Government commissioned Pierre Collin and Nicolas Colin to complete an examination of the issue of taxation of the digital economy.[190] The authors identified the intense use of data obtained from the 'regular and systematic monitoring of their user's activities'[191] as the common feature of all large digital economy corporations and concluded the following:

1. Data, particularly personal data, constitute the key resource of the digital economy. Collin and Colin concluded that the collection and analysis of the data enable these corporations to develop strategic plans and tailor future products and services to take advantage of the customer preferences disclosed by the data analysis.
2. The second point they make is that this data is collected without any monetary consideration to the corporations' customers, who supply the data. They argue that the 'data that they provide makes them (customers) production auxiliaries and they create value that gives rise to profits on different sides of the business models'.[192]

2.5 How Extensive Is Base Erosion and Profit Shifting?

2.5.1 Key Areas of BEPS

The task of identifying and measuring BEPS is a difficult one. The OECD accepted the challenge to accomplish this and in 2013 published *Addressing Base Erosion and Profit Shifting* ('BEPS Report'), a

[186] Hasnain Zaheer, Yvonne Breyer and John Dumay, 'Digital Entrepreneurship: An Interdisciplinary Structured Literature Review and Research Program' (2019) 148 *Technological Forecasting and Social Change* 119735 <https:doi.org/10.1016/j.techfore.2019.1199735>.

[187] Ibid.

[188] Ibid.

[189] Ibid 8.

[190] Collin and Colin (n 12).

[191] Ibid 2.

[192] Ibid.

report that acknowledged international taxation anti-avoidance laws and procedures had failed to adapt to recent developments, including globalisation, the advent of the digital economy, and advances in communication technology.[193] The BEPS Report suggested that international tax laws and agreed international tax standards were developed in a time characterised by considerably less cross-border economic activity than now. The BEPS Report claimed it had long been recognised by tax authorities (and presumably the OECD) that the interaction of different tax systems could result in an overlap of taxing rights and, consequently, double taxation.[194] The BEPS Report identified six key areas in which base erosion and profit shifting occurs:

1. international mismatches in entity and instrument characterization, including hybrid mismatch arrangements and arbitrage
2. application of treaty concepts to profits derived from the delivery of digital goods and services
3. tax treatment of related party debt-financing, captive insurance, and other intra-group financial transactions
4. transfer pricing, particularly in relation to the shifting of risks and intangibles, the artificial splitting of ownership of assets between legal entities within a group, and transactions between such entities that would rarely take place between independents
5. effectiveness of anti-avoidance measures, particularly general anti-avoidance rules ('GAARS'), controlled foreign company regimes, thin capitalisation rules, and rules to prevent tax treaty abuse
6. availability of harmful preferential regimes.

It is a difficult process, beyond the capabilities of this research but not of the OECD, to measure the scope of BEPS by analysing the data available from the World Bank as there are many factors to consider and certain specific skills required. Between 2013 and 2015, the OECD confirmed the potential magnitude of BEPS when they estimated:

> The global corporate income tax (CIT) revenue losses could be between 4% to 10% of global CIT revenues, i.e. USD 100 to 240 billion annually. The losses arise from a variety of causes, including aggressive tax planning by some multinationals, the interaction of domestic tax rules, lack of transparency and coordination between tax administrations, limited country enforcement resources and harmful tax practices. The affiliates of multinationals in low tax countries report almost twice the profit rate (relative to assets) of their global group, showing how BEPS can cause economic distortions. Estimates of the impact of BEPS on developing countries, as a percentage of tax revenues, are higher than in developed countries, given developing countries' greater reliance on CIT revenues. In a globalised economy, governments need to cooperate and refrain from

[193] *Addressing Base Erosion and Profit Shifting* (n 23).

[194] Ibid 5.

> harmful tax practices, to address tax avoidance effectively and provide a more certain international environment to attract and sustain investment. [195]

An examination of World Bank data by the OECD revealed that among OECD member countries, corporate income tax raises around 3% of the gross domestic product. This is about 10% of total tax revenues.[196]

Chapter 2 of the BEPS report investigated the extent of base erosion and profit shifting from the data then available from the World Bank.[197] The OECD acknowledges that it is difficult to reach solid conclusions on the extent of BEPS as most of the writing on the topic is inconclusive. The OECD also observes that abundant circumstantial evidence exists to suggest that BEPS activities are widespread.[198]

A study by Professor Kimberly Clausing found large discrepancies between the locations in which US-based multinationals report their profits for tax purposes and the locations of affiliates. The top ten locations for affiliate employment were the United Kingdom, Canada, Mexico, China, Germany, France, Brazil, India, Japan, and Australia. In contrast, the top ten locations for gross profits reporting were the Netherlands, Luxembourg, Ireland, Canada, Bermuda, Switzerland, Singapore, Germany, Norway, and Australia.[199]

2.5.2 Role of Foreign Direct Investment in BEPS

The OECD defines foreign direct investment ('FDI') as:

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[195] 'Explanatory Statement' (n 7).

[196] EU Tax Observatory, 'Global distribution of revenue loss from Tax Avoidance: re-estimation and country results. (27.05.2021) Global distribution of revenue loss from tax avoidance: re-estimation and country results - Eutax (taxobservatory.eu)

[197] Ibid.

[198] Eg, 5th Meeting of the OECD Parliamentary Group on Tax in association with the European Parliament Special Committee on Tax Rulings "Tackling Tax Avoidance - Implementing the BEPS

Measures" OECD Conference Centre, Paris, 2 May 2016, Summary.

Meg Hillier, Chair of the Public Accounts Committee in the UK House of Commons, stressed that the complexity of existing laws give multinational enterprises (MNEs) scope for exploiting loopholes to reduce their tax bills in the countries where they operate. International tax rules have not kept pace with how businesses operate globally and digitally, providing opportunities for MNEs and their financial advisors to construct artificial tax structures to undertake BEPS strategies. However, public sentiment around tax avoidance has changed and there is an increasing demand for a more transparent handling of corporate tax settlements. Ms Hillier stressed that MNEs must be more transparent about the location where they make profits and pay taxes.

Ms Hillier further recounted the inquiries launched by the Public Accounts Committee in 2012, 2013 and 2015.

During these investigations, the Committee found MNEs and their financial advisors using artificial tax structures to avoid UK taxes. The MNEs claimed to have complied with UK law, saying that they pay all tax required by the laws of every country where they operate. The Committee also found that the operations of HM Revenue and Customs Services (HMRC) were disadvantaged by the complexity of current laws and existing loopholes. Ms Hillier also reported on the significant criticism in response to the £130 million Google settlement reached with HMRC in February 2016. Members of parliaments have argued that the amount of UK tax Google pays does not appear to match the scale of its business in the UK. She also explained that the *Finance Act 2015* provided for public CBCR, and expressed strong concern about the challenges of VAT and the digital economy. In her closing remarks, she called for a European-wide parliamentary commitment to transparent CBCR.

[199] K. A. Clausing, 'The Revenue Effects of Multinational Firm Income Shifting' (2011) *Tax Notes* 1580-1586.

> Foreign direct investment (FDI) is a category of cross-border investment in which an investor resident in one economy establishes a lasting interest in and a significant degree of influence over an enterprise resident in another economy.[200]

FDI is an investment in the form of controlling ownership in a business in one country by an entity based in another country. It is distinguished from foreign portfolio investment by the concept of direct control. The motivation of the direct investor is a strategic long-term relationship with the direct investment enterprise to ensure a significant degree of influence by the direct investor in the management of the direct investment enterprise.[201] The 'lasting management interest' is acquired when the direct investor owns at least 10% of the voting stock of the direct investment enterprise operating in an economy other than that of the investor. Direct investment may also allow the direct investor to gain access to the economy of the direct investment enterprise, which it might otherwise be unable to do. The objectives of direct investment are different from those of portfolio investment, where investors do not generally expect to influence the management of the enterprise.[202]

The OECD and IMF compile statistics on foreign direct investments based on information collected at the national level. More in-depth analyses of this data may be of assistance in ascertaining the extent of BEPS. For example, a search of the IMF Coordinated Direct Investment Survey revealed that in 2010 three minor economies located in the Caribbean – Barbados, Bermuda, and the British Virgin Islands – received more foreign direct investments (combined 5.11% of global foreign direct investments) than the major economies Germany (4.77%) or Japan (3.76%). These three countries made more global investments in 2010 (4.54%) than Germany (4.28%). In a 2010 country-by-country comparison, the British Virgin Islands were the second-largest investor in China (14%) after Hong Kong (45%) and before the United States (4%). In the same year, Bermuda appeared as the third-largest investor in Chile (10%).[203]

The OECD made the following discovery upon examination of the IMF data:

> For example, total inward stock investments into the Netherlands for 2011 were equal to USD 3,207 billion. Of this amount, investments through special purpose entities (SPE) amounted to USD 2,625 billion. On the other hand, outward stock investments from the Netherlands were equal to USD 4,002 billion, with about USD 3,023 billion being made through SPEs. Similarly, in the case of Luxembourg, total inward stock investments for 2011 were equal to USD 2,129 billion, with USD 1 987 billion being made through SPEs. On

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[200] OECD, *Foreign Direct Investment (FDI)*, <https://www.oecd-ilibrary.org/finance-and-investment/foreign-direct-investment-fdi/indicator-group/english_9a523b18-n#:~:text=Foreign%20direct%20investment%20(FDI)%20is,enterprise%20resident%20in%20another%20economy>.

[201] *Addressing Base Erosion and Profit Shifting* (n 23) 17.

[202] 'Foreign Direct Investment', *Financial Times* (online, 31 October 2016) <http://lexicon.ft.com/Term?term=foreign-direct-investment>.

[203] *Addressing Base Erosion and Profit Shifting* (n 23) 17.

the other hand, outward stock investments from Luxembourg were equal to USD 2,140 billion, with about USD 1,945 billion being made through SPEs.[204]

The BEPS Report also disclosed that US business activity increased both domestically and abroad from 1989 through to 2004, but the relative share of activity that was based in foreign affiliates increased. The BEPS Report noted that the United Kingdom, Canada, and Germany are the leading foreign locations of US businesses by all measures *except income*. According to the BEPS Report, this is due to the reporting of the geographic sources of income being susceptible to manipulation for tax planning purposes and appears to be influenced by differences in tax rates across countries. This appears to be confirmed by the fact that most of the analysed countries with relatively low effective tax rates have significantly larger income shares than shares of the business measures least likely to be affected by income-shifting practices (physical assets, compensation, and employment), while the opposite relationship holds for most of the high-tax countries studied.[205]

A closer analysis of the data related to these structures may provide insights into the use of certain regimes to channel investments and intra-group financing from one country to another through conduit structures.

2.5.3 Studies of Effective Tax Rates of Multinationals

In 2009, Daniel Yorgason collected data on income and other taxes by surveying US multinationals and published the results in a paper prepared for the 4th Joint Session of the Working Group on International Investment Statistics and the Working Party on Globalisation of Industry and the Organisation for Economic Co-operation and Development.[206] The data for the study was collected on a yearly basis between 1982 and 2007 and disclosed that the effective average income tax rates borne in the period 2004–07 by US parent companies (22.8% in 2006) and US affiliates of non-US enterprises (28.8% in 2006) was much higher than the average for foreign affiliates (14.6% in 2006).[207]

In 2011, Markle and Shackelford analysed publicly available data from 28,343 financial statements of 11,602 public corporations between 1988 and 2009 to estimate the trend of country-level effective tax rates over that period. The corporations were spread over 82 countries. The study found that the location of the headquarters and the residence of its foreign subsidiaries affected a multinational's global effective tax rate.

[204] Ibid 18.

[205] Ibid.

[206] Daniel R. Yorgason, U.S. Department of Commerce, 'Collection of data on income and other taxes in surveys of U.S. multinational enterprises' (Paper prepared for the 4th Joint Session of the Working Group on International Investment Statistics and the Working Party on Globalisation of Industry, OECD, 2009).

[207] Ibid.

The study also revealed that the median effective tax rates for multinationals with headquarters in high-tax countries were approximately twice the rates in low-tax countries.[208]

In 2011, Avi-Yonah and Lahav examined the effective tax rates of the 100 largest US-based multinationals between 2001-2010 and compared the results with the effective tax rates of the largest 100 EU-based multinationals.[209] The study found that, although the US statutory corporate tax rate is 10% higher than the average statutory corporate tax rate in the EU, the effective tax rates are comparable and that EU multinationals tend to have a higher effective tax rate (on average approximately 34%) than US multinationals (on average approximately 30%).[210]

In 2012, research by JP Morgan disclosed that at least 60% (US$ 1.7 trillion) of US multinationals' cash was held offshore.[211] This report also suggests that collectively Global Tax Rate Makers show a weighted-average, 10-year, long-term effective tax rate of 22.4% and a simple-average, 10-year, long-term effective tax rate of 22.6%. Domestic Tax Rate Takers show a weighted average, 10-year, long-term effective tax rate of 36.2% and a simple-average, 10-year, long-term effective tax rate of 36.8%.[212]

It is debatable whether the examined studies provide conclusive proof that BEPS activities are increasing.

In 2003, Grubert, a tax analyst at the US Treasury, investigated the links between intangible income, intercompany transactions, income shifting and the choice of location by using data on US parent corporations and their manufacturing subsidiaries. The study revealed that income derived from research- and development-related intangibles accounted for about 50% of the income shifted from high-tax to low-tax countries. The study further revealed that research- and development-intensive subsidiaries performed substantial numbers of intercompany transactions and were well-placed for income shifting. The results also provide evidence of income shifting by research- and development-intensive US parent companies to very high-tax or very low-tax countries.[213]

A 2006 study by Professor Alfons Weichenrieder of the Goethe University attempted to identify profit shifting by examining the correlation between the home country tax rate of parent companies and the net tax

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[208] Kevin S. Markle and Douglas A. Shackelford, 'Cross-Country Comparisons of Corporate Income Taxes' (2012) 65(3) *National Tax Journal* 493–527.

[209] Reuven Avi-Yonah and Yaron Lahav, 'The Effective Tax Rate of the Largest US and EU Multinationals, University of Michigan Law School, Program in Law & Economics' (Law & Economics Working Papers No. 41, October 2011) <https://repository.law.umich.edu/law_econ_current/art41).

[210] Ibid.

[211] Emily Chasan, 'Big U.S. Companies, 60% of Cash Sits offshore: JP Morgan', *The Wall Street Journal* (online, 17 May 2012) <https://www.wsj.com/articles/BL-CFOB-2088>.

[212] JP Morgan, 'Global Tax Rate Makers: Undistributed Foreign Earnings Top $1.7 Trillion; At least 60% of Multinational Cash is Abroad', *North America Equity Research* (16 May 2012).

[213] Harry Grubert, 'Intangible Income, Intercompany Transactions, Income Shifting, and the Choice of Location' (March 2003) 56(1) *National Tax Journal* Part 2, 221–242.

profitability of their German subsidiaries.[214] The study, based on 116,632 firm-year observations from 1996 to 2003, found that for profitable subsidiaries directly owned by a foreign investor, a ten percentage point increase in the parent's home country tax rate resulted in about half a percentage point increase in the profitability of the German subsidiary.[215]

In 2008, a report by the United States General Accountability Office analysed Internal Revenue Service data on corporate taxpayers, including new data for 2004 and Bureau of Economic Analysis data on US multinationals' domestic and foreign operations. The average US effective tax rate on the domestic income of large corporations with positive domestic income in 2004 was an estimated 25.2%.[216] There was considerable variation in tax rates across these taxpayers, with about one-third of the taxpayers having effective rates of 10% or less and a quarter of the taxpayers having rates over 50%. The average United States effective tax rate on the foreign-source income of these large corporations was calculated to be around 4%, reflecting the effects of both the foreign tax credit (as the United States only imposes a residual tax on foreign income after crediting foreign taxes paid abroad on that income) and tax deferral (as foreign income is not taxed until repatriated to the United States).[217]

In 2008, Professor Michael McDonald updated, modified, and extended Grubert's 2003 research to investigate income shifting from intercompany transfer pricing. The analysis was based on theoretical and regression models developed by Grubert in 2003. The models were slightly modified to capture the effects of 'real' intercompany tangible, intangible, and services transactions (as opposed to interest 'income stripping' through intercompany or interbranch debt) and extended to incorporate data relating to cost-sharing arrangements. Although some caution is required when interpreting the transfer pricing implications from the regression results, the empirical analysis generally supports concerns about potential non-arm's length income shifting under current transfer pricing rules.[218]

In 2012, following his 2003 study, Grubert analysed data from a linked sample of 754 large non-financial US-based multinationals, obtained from the Treasury corporate income tax files, and found that the foreign

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[214] Alfons Weichenrieder, 'Profit Shifting in the EU – Evidence from Germany', (Institute for Fiscal Studies, 7 April 2006) <https://ifs.org.uk/conferences/etpf_weichenreider.pdf>.

[215] Ibid.

[216] United States Government Accountability Office, 'US Multinational Corporations: Effective Tax Rates Are Correlated with Where Income Is Reported', (Report to the Committee on Finance, U.S. Senate, August 2008,) 3. <www.gao.gov/assets/gao-08-950.pdf>.

[217] Ibid 4.

[218] Michael McDonald, 'Income Shifting from Transfer Pricing: Further Evidence from Tax Return Data' (OTA Technical Working Paper 2, July 2008) <www.treasury.gov/resource-center/tax-policy/tax-analysis/Documents/TP-2.pdf>.

share of the worldwide income of US multinationals had risen sharply in recent years.[219] The data indicated that the multinationals' foreign income share increased by 14 percentage points from 1996 to 2004. The differential between a company's US and foreign effective tax rates exerts a significant effect on the share of its income abroad, largely through changes in foreign and domestic profit margins rather than a shift in sales. US-foreign tax differentials are estimated to have raised the foreign share of multinationals' worldwide income by about 12 percentage points by 2004.[220] Lower foreign effective tax rates had no significant effect on a company's domestic sales or the growth of its worldwide pre-tax profits. Lower taxes on foreign income do not seem to promote 'competitiveness'.[221]

Multinationals can have different average effective foreign tax rates because they have different opportunities for the location of their activities. In other words, some MNEs' choice of location is more responsive to tax differences. For example, mobile high-tech multinationals that serve a worldwide market can easily be located in low-tax jurisdictions. In contrast, some MNEs find it more efficient to be located near their customers, even if they reside in a high-tax country.[222]

As a side issue, Grubert's study found that the allocation of debt among subsidiaries and the shifting of R&D-based intangible income together account for virtually all the observed differences in profitability between high- and low-tax countries.[223]

A 2015 report by Jane Gravelle, Senior Specialist in Economic Policy, United States Congressional Research Service, concluded that:

> Multinational firms can artificially shift profits from high-tax to low-tax jurisdictions using a variety of techniques, such as shifting debt to high-tax jurisdictions. Because tax on the income of foreign subsidiaries (except for certain passive income) is deferred until income is repatriated (paid to the U.S. parent as a dividend), this income can avoid current U.S. taxes, perhaps indefinitely. The taxation of passive income (called Subpart F income) has been reduced, perhaps significantly, by using hybrid entities that are treated differently in different jurisdictions. The use of hybrid entities was greatly expanded by a new regulation (termed check-the-box) introduced in the late 1990s that had unintended consequences for foreign firms. In addition, earnings from income that is taxed often can be shielded by foreign tax credits on other income. On average, very little tax is paid on the foreign source income of U.S. firms. Ample evidence of a significant amount of profit shifting exists, but the revenue cost estimates vary substantially. Evidence also indicates a

[219] Harry Grubert, 'Foreign Taxes and the Growing Share of U.S. Multination Company Income Abroad: Profits, Not Sales, Are Being Globalized' (Office of Tax Analysis Working Paper No. 103, February 2012) 2 <www.treasury.gov/resource-center/tax-policy/taxanalysis/Documents/OTA-W2012-103-Multinational-Income-GlobalizedFeb-2012.pdf>.

[220] Ibid.

[221] Ibid.

[222] Ibid 9.

[223] Ibid.

> significant increase in corporate profit shifting over the past several years. Recent estimates suggest losses that may approach, or even exceed, $100 billion per year.[224]

Focusing on the activities of European multinationals, a 2006 study conducted by European Commission staff members Professor Harry Huizinga and Luc Laeven, former Lead Economist in the Research Department of the International Monetary Fund and now Director-General of the Directorate General Research of the European Central Bank, discovered that significant international tax rate differences provide European multinationals with strong incentives to re-allocate profits internationally:

> Our model yields the prediction that a multinational's profit shifting in a country depends on a weighted average of international tax rate differences between all countries where the multinational is active. Using a unique dataset containing detailed firm-level information on the parent companies and subsidiaries of European multinationals and detailed information about the international tax system, we test our model and empirically examine the extent of intra-European profit shifting by European multinationals. On average, we find a semi-elasticity of reported profits with respect to the top statutory tax rate of 1.43, while shifting costs are estimated to be 1.6 percent of the tax base. International profit shifting leads to a substantial redistribution of national corporate tax revenues. Many European nations appear to gain revenues from profit shifting by multinationals largely at the expense of Germany.[225]

In 2012, Dischinger claimed the research he conducted provided indirect empirical evidence of profit-shifting behaviour by multinationals:

> This issue is analyzed in an econometric panel study for the years 1995 to 2005 and additionally in a cross-section for 2004 using a large micro database of European subsidiaries of multinationals (AMADEUS) which includes detailed balance sheet items. Our results show a decrease in the unconsolidated pre-tax profits of an affiliated company of approximately 7% if the difference in the statutory corporate tax rate of this affiliate to its parent increases by 10 percentage points. Various robustness checks support our profit shifting evidence. Furthermore, the results suggest an overall shift of profits out of the European Union. In addition, we provide evidence that a higher parent's ownership share of its subsidiary leads to intensified profit shifting behavior.[226]

A 2012 study by Professor Dhammika Dharmapala and Professor Nadine Riedel recorded earnings increases at the parent firm and investigated how these increased profits propagate across low-tax and high-tax entities within the multinational group. The study applied this approach to European multinationals' affiliates from 1995 to 2005 and found that parents' positive earnings shocks are associated with a significant increase in pre-tax profits at low-tax affiliates, relative to the effect on the pre-tax profits of high-tax affiliates. Based on

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[224] Jane G. Gravelle, 'Tax Havens: International Tax Avoidance and Evasion' (CRS Report for Congress, United States Congressional Research Service, 3 September 2015) <https://www.fas.org/sgp/crs/misc/R40623.pdf>.

[225] Harry Huizinga and Luc Laeven, 'International profit shifting within multinationals: A multi-country perspective' (Economic Papers No. 260, December 2006) <http://ec.europa.eu/economy_ finance/publications/publication590_en.pdf>.

[226] Matthias Dischinger. 'Profit Shifting by Multinationals: Indirect Evidence from European Micro Data' (Munich Discussion Paper No. 2007-30, University of Munich, Department of Economics, 2007).

additional tests, the study suggests that this estimated effect is attributable primarily to the strategic use of debt across affiliates.[227]

It is widely documented that one of the methods by which multinationals reduce their global tax liability is through profit shifting.[228] There have been many reports and studies in recent years studying both the causes and consequences of tax planning by multinationals with the effect of reducing the corporate income tax liability. A 2012 study by Professors Jost Heckemeyer and Michael Overesch provides a quantitative review of the empirical literature on the profit-shifting behaviour of multinationals. The study examined evidence from 23 studies and uncovered indirect evidence for profit shifting based on the inverse relationship between reported taxable profit and the difference between the local tax rate and tax levels at other group locations. The study also advanced that transfer pricing and licensing rather than inter-company debt is the dominant profit-shifting vehicle.[229]

On 8 July 2020, the OECD released a report claiming that new OECD data provides aggregated information on the global tax and economic activities of nearly 4,000 MNE groups, headquartered in 26 jurisdictions and operating across more than 100 jurisdictions worldwide.[230] The data, released in the OECD's annual *Corporate Tax Statistics* publication, is a major output based on the Country-by-Country ('CbC') reporting requirements for MNEs under the OECD/G20 BEPS Project. The BEPS Project has seen more than 135 jurisdictions collaborating to tackle tax avoidance strategies by MNEs that exploit gaps and mismatches in international tax rules to avoid paying tax.[231]

CbC reporting requires large MNEs to disclose important information about their profits, tangible assets, employees, and where they pay their taxes in every country in which they operate. Country-by-Country Reports ('CbCR's) provide tax authorities with the information needed to analyse MNE behaviour for risk assessment purposes and will support the improved measurement and monitoring of BEPS. The anonymised and aggregated CbCR statistics provided to the OECD by member jurisdictions of the Inclusive Framework on BEPS. This latest dataset contains a vast array of aggregated data on the global tax and economic activities of MNEs, including profit before income tax, income tax paid (on a cash basis), current year

[227] Dhammika Dharmapala and Nadine Riedel, 'Earnings Shocks and Tax-Motivated Income-Shifting: Evidence from European Multinationals' (2013) 97 *Journal of Public Economics* 95–107.

[228] See, eg, *Addressing Base Erosion and Profit Shifting* (n 23).

[229] Jost Heckemeyer and Michael Overesch, 'Profit Shifting Channels of Multinational Firms – a Meta Study' (Conference Paper, IIPF Congress, August 2012) <http://editorialexpress.com/cgi-bin/conference/download.cgi?db_name=IIPF68&paper_id=434>.

[230] 'New Corporate Tax Statistics Provide Fresh Insights into the Activities of Multinational Enterprises', *OECD* (Web Page, 08 July 2020) <https://www.oecd.org/tax/new-corporate-tax-statistics-provide-fresh-insights-into-the-activities-of-multinational-enterprises.htm>.

[231] Ibid.

income tax accrued, unrelated, and related party revenues, number of employees, tangible assets, and the main business activity (or activities) of MNEs.[232]

While the data contain some limitations and it is not possible to detect trends in BEPS behaviour from a single year of data, the new statistics suggest a number of preliminary insights:

- There is a misalignment between the location where profits are reported and the location where economic activities occur, with MNEs in investment hubs reporting a relatively high share of profits compared to their share of employees and tangible assets.
- Revenues per employee tend to be higher where statutory CIT rates are zero and in investment hubs.
- On average, the share of related party revenues in total revenues is higher for MNEs in investment hubs.
- The composition of business activity differs across jurisdiction groups, with the predominant business activity in investment hubs being 'holding shares and other equity instruments.'

2.5.4 The OECD's Two Pillar Solution

Following the publication of *Addressing Base Erosion and Profit Shifting* in 2013, the OECD conducted an extensive campaign to reduce BEPS, as evidenced by the publication of over 30 reports produced for the specific purpose of reducing BEPS.[233] Research for this paper has not, however, uncovered any proof that BEPS has been reduced.

The OECD and G20 have been working for the past two years on a two-pillar approach to international tax reform to address the taxation of the digital economy and unresolved BEPS issues.[234]

On 8 October 2021, 136 countries of the OECD/G20 Inclusive Framework announced they had agreed to this two-pillar solution.[235] The accompanying statement by the OECD reports that the changes to implement

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[232] 'About the Dataset Country-by-Country Reporting Requirements', *OECD* (Web Page) <https://qdd.oecd.org/subject.aspx?Subject=CBCR_REQ>.

[233] OECD, *Harmful Tax Practices - 2018 Progress Report on Preferential Regimes Inclusive Framework on BEPS: Action 5* (OECD Publishing, 2019); *Prevention of Treaty Abuse - Peer Review Report on Treaty Shopping Inclusive Framework on BEPS: Action 6* (OECD Publishing, 2019) < https://www.oecd.org/tax/beps/prevention-of-treaty-abuse-peer-review-report-on-treaty-shopping-9789264312388-en.htm>; OECD, 'Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy' (OECD Publishing, 2019); OECD/G20, *Inclusive Framework on BEPS* (OECD Publishing, 2019) < https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf>; OECD, 'OECD/G20 Inclusive Framework on BEPS: Progress Report July 2018-May 2019' < https://www.oecd.org/tax/beps/inclusive-framework-on-beps-progress-report-july-2018-may-2019.pdf>; OECD, 'Making Dispute Resolution More Effective - MAP Peer Review Reports Batch 6 (Stage 1) Inclusive Framework on BEPS: Action 14' (OECD Publishing, 2019).

[234] Jason Osborn, Michael Lebovitz, and Astrid Pieron, 'Unilateral taxation of the Digital Economy', *Tax Executive* (Web Page, 12 May 2020) < https://taxexecutive.org/unilateral-taxation-of-the-digital-economy/>.

[235] Patrick Marley, Peter Macdonald, Taylor Cao and Matias Milet, '136 countries agree to OECD/G20 Inclusive Framework's two-pillar solution to international tax reform' (12 October 2021) *OSLER*.

Pillar One would be done primarily through a to-be-developed multilateral convention to be signed in mid-2022 and to come into effect in 2023. Rules to give effect to the Pillar Two changes published on 20 December 2021, with an additional multilateral instrument to be developed by mid-2022 and an implementation framework by the end of 2022.[236]

Marley et al further observed that according to the report, the three key elements of Pillar One remain the same:

- a new taxing right for market jurisdictions (where customers are located) to obtain a share of residual profit of an MNE (Amount A);
- the calculation of a fixed return for certain baseline and marketing and distribution activities in jurisdictions where an MNE has a physical presence (Amount B); and
- dispute prevention and resolution mechanisms (referred to by the OECD as 'tax certainty').[237]

Marley et al report that the scope of targeted MNEs has remained the same as previously announced in July 2021 and is focused on the largest and most profitable MNEs (having moved away from the concept of applying the rules only to digital businesses or consumer-facing businesses). The following rules apply (the first three of which are the same as in the July 2021 statement):

- MNEs will be in-scope if they have a global turnover above €20 billion and profitability above 10%, with the revenue threshold to be reduced to €10 billion pending successful implementation (determined 7–8 years after Pillar One comes into effect), including with respect to tax certainty on Amount A.
- Profits and losses are to be measured by reference to financial accounting income, with a small number of adjustments. Losses will be carried forward (although it is unclear whether the carry-forward period will be indefinite).
- Segmentation will occur only in exceptional circumstances where, based on the segments disclosed in the financial accounts, a segment meets the scope rules.
- 25% of residual profit (defined as profit in excess of 10% of revenue) will be allocated to market jurisdictions with sufficient nexus (measured using a revenue-based allocation key). The July 2021 statement had specified a 20%–30% range.[238]

The OECD statement confirms the special purpose nexus rule remains as previously announced to determine whether an MNE has a sufficient nexus such that Amount A must be calculated for that jurisdiction — at

[236] Ibid.

[237] Ibid.

[238] Ibid.

least €1 million in revenue from that jurisdiction (or €250,000 for jurisdictions with a GDP below €40 billion).[239]

The OECD statement does not, however, provide any additional guidance on how to calculate revenue sourcing except to say that detailed rules will be developed. The previously announced marketing and distribution profits safe harbour to apply where the residual profits of an in-scope MNE are already taxed in a market jurisdiction remains part of the framework, but no further details were included.[240] Double taxation is to be eliminated through either the exemption or credit method, with the entity (or entities) earning residual profit bearing the tax liability for Amount A.[241]

Further, the OECD statement does not provide any further details on the mandatory and binding dispute prevention and resolution mechanisms contemplated to avoid double taxation for Amount A. It confirms that the dispute prevention and resolution mechanisms will be elective for developing countries that are eligible for deferral of the BEPS Action 14 peer reviews and have no or low levels of mutual agreement procedure ('MAP') disputes.[242]

Marley et al theorise that the incentive offered to MNEs as part of this new framework is that the MLI will require countries to remove all digital services taxes and other relevant similar measures and commit to not introducing such measures in the future.[243] The parties committed not to impose any new digital services taxes or other relevant similar measures from 8 October 2021 until the earlier of 31 December 2023 or the coming into force of the MLI. The details as to exactly which taxes meet the digital services tax definition are not specified, and the timing and method for removing existing taxes are not specified.[244]

Pillar One

Pillar One applies to MNEs with a global turnover above €20 billion and profitability above 10%. For determining whether a jurisdiction qualifies for the Amount A allocation or not, a new special-purpose nexus rule is to be applied. The applicability would depend upon whether the in-scope MNE derives at least €1 million in revenue from the jurisdiction or not. However, in the case of smaller jurisdictions with a GDP lower than €40 billion, the nexus threshold will be €250,000.[245]

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[239] Ibid.

[240] Ibid.

[241] Ibid.

[242] Ibid.

[243] Ibid.

[244] Ibid.

[245] 'Statement on a Two-Pillar Solution' (n 14).

Amount A will allocate 25% of 'residual profits' (defined as profit in excess of 10% of revenue) to market jurisdictions that meet the nexus test. The allocation is to be made by using a revenue-based allocation key. Mandatory and binding dispute prevention and resolution mechanisms designed to avoid double taxation for Amount A, including all issues related to Amount A (for example, transfer pricing and business profits dispute), will be available for in-scope businesses. For some developing countries (jurisdictions with low levels of mutual agreement procedures), an elective binding dispute resolution mechanism will be available.

An MLI is to be executed to remove all Digital Services Taxes and other similar measures with respect to all companies. As part of this measure, no newly enacted Digital Services Taxes or other similar measures will be imposed on any company from 8 October 2021 and until the earlier of 31 December 2023 or the coming into force of the MLI. Amount A will be implemented through an MLI and, when necessary, through correlative changes to domestic law. The MLI will be developed by early 2022, with the goal of enabling it to enter into force and effect in 2023 once a critical mass of jurisdictions has ratified it. Detailed rules are to be developed on Revenue Sourcing.[246]

On Amount B, the application of the arm's length principle to in-country baseline marketing and distribution activities will be simplified and streamlined, with a particular focus on the needs of low-capacity countries. This work will be completed by the end of 2022.[247]

The OECD statement acknowledges that changes to domestic law may be necessary to implement the Pillar One proposals. The Commentary to the Globe Rules was published on 14 March 2022.[248]

Pillar Two

Marley et al summarise the OECD statement timeframe with respect to Pillar Two as follows:

- Model rules to give effect to the domestic GloBE rules will be developed by the end of November 2021.
- An MLI will be developed by mid-2022 to facilitate the implementation of the GloBE rules in relevant bilateral treaties.
- By the end of 2022, an implementation framework will be developed that facilitates the coordinated implementation of the GloBE rules. This implementation framework will cover agreed administrative procedures (e.g., detailed filing obligations and multilateral review processes) and safe harbours to facilitate both compliance by MNEs and administration by tax authorities and may

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[246] Ibid.

[247] 'Alerts: Direct Tax Alert – OECD releases statement of Pillar 1 and Pillar 2' *BDO India* (Insights, 23 November 2021) <https://www.bdo.in/en-gb/insights/alerts-updates/direct-tax-alert-oecd-releases-statement-of-pillar-1-and-pillar-2>.

[248] Ibid. See also OECD, *Commentary to the Globe Rules* (OECD Publishing, 14 March 2022).

include a multilateral convention in order to further ensure coordination and consistent implementation of the GloBE rules.[249]

OECD/G20 has now published the GloBE rules for Pillar Two. The Executive Summary provides the following:[250]

- The GloBE rules provide for a coordinated system of taxation intended to ensure large MNE groups pay a minimum level of tax on the income arising in each of the jurisdictions where they operate. It does so by imposing a top-up tax on profits arising in a jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum rate.
- Chapter 1 defines the scope of the GloBE rules.
- Chapter 2 determines the constituent entities in the group that are liable for any top-up tax and the portion of any top-up tax charged to any such entity.
- Chapters 3 and 4 set out the components of the effective tax rate calculation under the GloBE rules. Chapter 3 determines the income (or loss) for the period for each constituent entity in the MNE Group.
- Chapter 4 then identifies the taxes attributable to such income.
- Chapter 5 aggregates the income and taxes of all constituent entities located in the same jurisdiction to determine the effective tax rate for that jurisdiction. If the effective tax rate is below the minimum rate, the difference results in a top-up tax percentage which is applied to the jurisdictional income to determine the total amount of top-up tax. The top-up tax is pro-rated amongst the constituent entities located in that jurisdiction and then charged to the constituent entities liable for any top-up tax in accordance with Chapter 2. Chapter 5 also includes an elective substance-based income exclusion that may reduce the profit amounts subject to any top-up tax.
- Chapter 6 contains rules relating to acquisitions, disposals and joint ventures.
- Chapter 7 deals with the application of the GloBE rules to certain tax neutrality and other distribution regimes.
- Chapter 8 covers administrative aspects of the GloBE rules, including information filing requirements and the application of any safe harbours.
- Chapter 9 sets out certain transitional rules.
- Chapter 10 sets out defined terms used in the GloBE rules.

The GloBE rules apply a minimum rate on a jurisdictional basis. In that context, the OECD/G20 Inclusive Framework on BEPS agreed, in its 8 October 2021 statement, that consideration will be given to the

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[249] Ibid.

[250] OECD, *Tax Challenges Arising from the Digitalisation of the Economy Global Anti-Base Erosion Model Rules (Pillar Two): Inclusive Framework on BEPS* (OECD Publishing, Paris, 2010).

conditions under which the US Global Intangible Low-Taxed Income regime will co-exist with the GloBE rules to ensure a level playing field.[251]

The MLI will be developed, which will contain the rules necessary to determine and allocate Amount A and eliminate double taxation, as well as the simplified administration process, the exchange-of-information process, and the dispute prevention and resolution processes. The MLI will be supplemented by an Explanatory Statement that describes the purpose and operation of the rules and processes. The OECD/G20 Inclusive Framework aims to have the text of the Multilateral Convention and the Explanatory Statement ready by early 2022, hold the signing ceremony by mid-2022, and have the MLI enter into force in 2023, once a critical mass of jurisdictions has ratified it.

2.6 Conclusion

The literature reviewed in this chapter confirmed the various reports published by the OECD concerning base erosion and profit shifting and identified the key areas exploited by multinational entities to minimise their tax globally. Actions taken to reduce BEPS are designed to substantially reduce the incidence of base erosion and profit shifting. The OECD reports *Corporate Tax Statistics Database* discussed below do not appear to contain any data relevant to the increase or decrease in BEPS from 2013 until the present, nor do any of the other BEPS-related reports of the OECD reviewed so far.[252]

The OECD expects the two-pillar approach to pay dividends in terms of reduction in BEPS. It may pay dividends provided MNEs play by the 45 pages of model rules and 15 pages of definitions. It is possible that new forms of commercial cooperation and activity will be developed that possess characteristics that enable circumventing these rules.[253]

The Model Rules are not to be read in isolation as the OECD is working with the Inclusive Framework to publish an accompanying commentary, which is expected to be released in 'early 2022'. That commentary will be instructive to jurisdictional legislatures as it is expected to explain the rationale behind the components of the Model Rules and will therefore likely inform drafting decisions when introducing them into domestic law. The Inclusive Framework will also develop an 'Implementation Framework' for the GloBE rules during 2022 that is expected to include further guidance on the rules' application. The two-pillar approach may only add further layers of complexity and cost of compliance to an already over-complicated and increasingly costly and unmanageable global tax regime

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[251] OECD, *Tax Challenges Arising from the Digitalisation of the Economy – Global Anti-Base Erosion Model Rules (Pillar Two)*, (OECD Publishing, 20 December 2021).

[252] OECD, *Corporate Tax Statistics: Third Edition* (OECD Publishing, 2021) < https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-third-edition.pdf>.

[253] 'Alerts: Direct Tax Alert – OECD releases statement of Pillar 1 and Pillar 2' (n 247).

Pillar Two is also more than just a global minimum tax regime. A treaty mechanism designed to protect developing jurisdictions (referred to as the 'Subject to Tax Rule') will be implemented. This will be published in 2022 with a public consultation scheduled for March.[254]

The following chapter examines the global bilateral tax treaty regime.

[254] See 'Pillar Two: Model Global Minimum Tax Regime Revealed' *Baker McKenzie* (Insight, 23 December 2021) <https://www.bakermckenzie.com/en/insight/publications/2021/12/model-global-minimum-tax-regime-revealed>.

CHAPTER 3: THE BILATERAL TAX TREATY REGIME

3.1 Introduction

Chapter 2 examined certain concepts and characteristics of the international tax regime to establish a suitable foundation upon which to build the case for a multilateral model tax treaty as a contingency strategy in the event of the failure of the BEPS Action Plan to reduce international tax avoidance. This chapter continues to build upon this foundation by examining the history and ongoing development of the OECD *Model Tax Convention on Income and on Capital* ('Model Convention'). Intrinsic to this analysis is an understanding of the multifaceted role of the OECD in international taxation, particularly as the developer of the Model Convention that has hitherto so successfully coordinated and regulated the international tax regime.

As such, the OECD occupies a pivotal position in the international taxation regime. The current bilateral tax treaty network is substantially based on the OECD Model Convention, while many of the anti-avoidance measures written into domestic laws were designed and recommended by the OECD. The role played by the OECD in establishing this network and guiding its operation and development up to the present time is therefore essential to this study. An in-depth analysis of the OECD itself is beyond the scope of this research but is dealt with briefly in subsequent paragraphs.

This chapter also examines the *Model Tax Convention on Income and on Capital* and assesses its performance in dealing with issues that have assumed increasing importance for countries in the 21st century. This examination initiates a comparison of the views of the OECD and of other tax experts in assessing the role of the Model Convention in international tax avoidance, commonly called BEPS. A brief analysis of the BEPS Action Plan and the Multilateral Convention completes the chapter.

3.2 Role of the Organisation for Economic Co-operation and Development in International Taxation

The OECD was formed following World War II and was initially called Organisation for European Economic Cooperation.[255] The OEEC then became the Organisation for Economic Cooperation and Development, which later expanded to its current membership of 38 countries.[256] It is necessary to examine the Articles of the OECD Convention to understand the role of the OECD and its relationship with both OECD members and non-members. The aim of the OECD, according to Article 1, is to 'promote policies designed to achieve the highest sustainable economic growth and employment and a rising standard of living in Member countries…'.[257] The role of the OECD with respect to *non-members* is to 'promote policies

[255] 'Organisation for European Economic Co-operation' *OECD* (Web Page) <http://www.oecd.org/general/organisationforeuropeaneconomicco-operation.htm>.

[256] *History* (n 5).

[257] 'Discover the OECD', *OECD* (Web Page) <https://www.oecd.org/general/Key-information-about-the-OECD.pdf>.

designed to contribute to sound economic expansion in Member as well as non-member countries in the process of economic development'.[258] Article 5 empowers the OECD to 'take decisions binding on all the members'.[259] However, the OECD has no enforcement powers with respect to tax rules. Its role is primarily that of establishing best practice guidelines via domestic legislation or treaties.

International taxation is in a constant state of transformation as multinationals take advantage of gaps and discrepancies in tax treaties and domestic laws to reduce or eliminate tax liabilities. Jurisdictions adversely affected by these activities amend their domestic laws unilaterally, or in accord with the OECD's recommendations, to prevent erosion of tax revenue. The decision taken in the 1920s to develop a bilateral model tax treaty has resulted in the current tax network of over 3,500 bilateral tax treaties. The differences between domestic tax laws at that time discouraged the League of Nations from pursuing suggestions by some countries for a multilateral model tax treaty.[260] From 1948 to 1960, and subsequently, the OECD assumed responsibility for maintaining and updating the model tax treaty first developed in 1928. As part of this process, the OECD Committee on Fiscal Affairs remains in consultation with OECD members and, when necessary, releases draft updates to the OECD Model for discussion and negotiation by OECD members.[261]

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[258] 'Convention on the Organisation for Economic Co-operation and Development', *OECD* (Web Page) <https://www.oecd.org/general/conventionontheorganisationforeconomicco-operationanddevelopment.htm>.

[259] Ibid.

[260] See, eg, Vito Tanzi and Howell Zee, 'Tax Policy for Developing Countries' (Economic Issues 27, International Monetary Fund, 2001) <http://www.imf.org/external/pubs/ft/issues/issues27/index.htm>.

Vito Tanzi and Howell Zee investigate the various tax systems available to developing countries.

'Another concern in the choice between taxing income and taxing consumption involves their relative impact on equity. Taxing consumption has traditionally been thought to be inherently more regressive (that is, harder on the poor than the rich) than taxing income. Doubt has been cast on this belief as well. Theoretical and practical considerations suggest that the equity concerns about the traditional form of taxing consumption are probably overstated and that, for developing countries, attempts to address these concerns by such initiatives as graduated consumption taxes would be ineffective and administratively impractical.'

See also Vann (n 4). The best-known example of this problem is the debate that has occurred between Germany and the US in relation to differences in their corporate tax systems. Germany sought to introduce differential dividend tax rates in its treaty framework but this was strenuously resisted by the US even though the result has in the past been to bias the German tax system against firms which are owned by German residents in the case of reinvestment of profits, compared to foreign owned firms.19 It is noteworthy again that this problem is specifically one relating to corporate groups. The apparently reciprocal dividend rates were argued to favour investment by US parent corporations in German subsidiaries, as compared to investment by

German residents in German corporations and by German parent corporations in US subsidiaries.

[261] See, eg, 'Discussion Draft Released on 2005 Update to the Model Tax Convention', *OECD* (Web Page) <http://www.oecd.org/ctp/treaties/discussiondraftreleasedon2005updatetothemodeltaxconvention.htm>.

Unilateral changes to tax laws by countries can have the effect of creating more discrepancies between their tax systems and thereby creating additional opportunities for tax avoidance by multinationals.[262] To mitigate this outcome, the OECD periodically consults with OECD members, businesses, and other interested parties to update the OECD Model Convention to take account of new developments. For example, in June 2011 the OECD Centre for Tax Policy and Administration published a document entitled *Transfer Pricing Legislation – a Suggested Approach*.[263] The role of the OECD in preparing and publishing this document is clearly explained in the following accompanying *Disclaimer,* which is quoted in its entirety to illustrate the fundamental role of the OECD in international taxation:[264]

The introduction to the paper explains that it has been prepared by the OECD Secretariat and that it contains an approach to the drafting of domestic transfer pricing legislation suggested by the OECD. It is further stated that the paper is intended to provide countries that are developing transfer pricing rules with a suggested structure and content for their legislation. It continues to describe the paper as *purely illustrative*; and suggests that countries adapt their approach to suit their own circumstances and priorities, as well as their legislative language and Conventions.[265] The paper is directed at both developed and developing

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[262] See, eg, *Addressing Base Erosion and Profit Shifting* (n 23) 7.

'More fundamentally, a holistic approach is necessary to properly address the issue of BEPS. *Government actions should be comprehensive and deal with all the different aspects of the issue.* These include, for example, the balance between source and residence taxation, the tax treatment of intragroup financial transactions, the implementation of anti-abuse provisions, including CFC legislation, as well as transfer pricing rules. A comprehensive approach, globally supported, should draw on an in-depth analysis of the interaction of all these pressure points. It is clear that co-ordination will be key in the implementation of any solution, though countries may not all use the same instruments to address the issue of BEPS'. See also p. 8.

Because many BEPS strategies take advantage of the interface between the tax rules of different countries, it may be difficult for any single country, acting alone, to fully address the issue. Furthermore, unilateral and uncoordinated actions by governments responding in isolation could result in the risk of double – and possibly multiple – taxation for business. This would have a negative impact on investment, and thus on growth and employment globally. In this context, the major challenge is not only to identify appropriate responses, but also the mechanisms to implement them in a streamlined manner, in spite of the well-known existing legal constraints, such as the existence of more than 3 000 bilateral tax treaties. *It is therefore essential that countries consider innovative approaches to implement comprehensive solutions.*

[263] OECD, 'Transfer Pricing Legislation – A Suggested Approach' <http://www.oecd.org/tax/transfer-pricing/45765682.pdf>.

[264] 'TPG 1995 Preface Paragraph 18', *TPGuidelines* (Web Page) <https://tpguidelines.com/tpg1995-preface-paragraph-18/>. This paper, which has been prepared by the OECD Secretariat, contains a suggested approach to the drafting of transfer pricing legislation. It is intended to provide countries that are developing transfer pricing rules with a suggested structure and content for their legislation. It is purely illustrative; countries will want to adapt their approach to suit their own circumstances and priorities, as well as their legislative language and conventions. This paper bears no legal status and the views expressed therein do not necessarily represent the views of the OECD member states. For a more comprehensive description of the views of the OECD and its member states in relation to the arm's length principle and transfer pricing, readers are invited to refer to the OECD Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations which were approved by the Committee on Fiscal Affairs on 27 June 1995 and by the Council of the OECD for publication on 13 July 1995 [C(95)126/FINAL] and were supplemented and updated since (the most recent update of the Transfer Pricing Guidelines was approved by the Council on 22 July 2010, see www.oecd.org/ctp/tp.

[265] Ibid. 'Of course, transfer pricing legislation is not sufficient to resolve all the international tax issues that

may arise for a country. In particular, while transfer pricing legislation is part of the measures needed

countries. Similarly, the OECD has provided general guidance to countries to assist in the drafting of domestic legislation relating to issues related to tax evasion and tax avoidance.

An understanding of the role of the OECD in international taxation is a prerequisite to understanding international taxation and will be briefly undertaken. The OECD's work on tax matters is conducted within the Committee on Fiscal Affairs ('CFA'), assisted by the Centre for Tax Policy and Administration (technical expertise) and covers the full array of domestic and international tax issues. David Ernick of Price, Waterhouse Coopers advances that the OECD Model Convention has become the preferred model for 'a broad network of tax treaties across the world'.[266] The Model Convention helps avoid double taxation by establishing rules for taxing income and capital and by providing rules for allocating taxing rights between residence and source countries. Residence countries are generally allocated responsibility for eliminating double taxation where taxing rights compete.[267]

The OECD also publishes the *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* ('Transfer Pricing Guidelines'), which provide guidance on the international consensus on transfer pricing. As with the OECD Model Convention, the Transfer Pricing Guidelines address issues of double taxation and tax avoidance that can arise from disputes between tax administrations and with multinationals regarding cross-border transactions between associated enterprises. The CFA constantly monitors all the major areas of international taxation and updates the Model Convention when necessary. The Transfer Pricing Guidelines, which regulate the internal operations of multinationals, are continuously reviewed and updated.[268]

Transfer pricing has become a global issue, as it taxes internal transfers within MNEs on the same basis as transfers between non-related entities. In 2012, the OECD organised its first annual meeting of the new

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to tackle international tax avoidance, it does not replace anti-abuse rules and/or controlled foreign

company's legislation that may be needed to fight abusive transactions.'

[266] David Ernick, 'Base Erosion, Profit Shifting and the Future of the Corporate Income Tax' (2013) 42 *Tax Management International Journal* 671 (1):

'Unlike the role of the World Trade Organization in setting binding rules in the trade area and imposing sanctions for violations of those rules, the OECD has no enforcement powers with respect to tax rules; it is primarily a standard setting organisation, promulgating guidelines and best practices that become implemented through domestic legislation or treaties only to the extent they are persuasive. Nonetheless, the CFA has been quite influential with respect to tax issues. The OECD *Model Tax Convention on Income and Capital* (the 'Model Tax Convention') has become the foundation for a broad network of tax treaties across the world, and the OECD Transfer Pricing Guidelines (Guidelines) have become the model for domestic transfer pricing legislation in all OECD countries and in most non-OECD economies.'

[267] Ibid 2. See also OECD, *Resolution of the Council on the Mandate of the Committee on Fiscal Affairs* [C (2008)147 and C/M (2008)20, item 285)] 1(i)(b)(2) (The CFA shall ''promote communication between countries and the adoption of appropriate policies to prevent international double taxation and to counteract tax avoidance and evasion').

[268] Ibid. See also *Recommendation of the Council on the determination of transfer pricing between associated enterprises* [C(95)126/Final] (noting 'the fundamental need for co-operation among tax administrations in order to remove the obstacles that international double taxation presents to the free movement of goods, services, and capital between Member countries).'

Global Forum on Transfer Pricing, which brought together transfer pricing experts from almost 90 countries. Ernick acknowledged that the OECD had conducted significant work on harmful tax practices, transparency and exchange of information, and aggressive tax planning:

> [The OECD] also conducted significant work on international tax cooperation and on harmful tax practices. Work in this area includes the Harmful Tax Practices Project, which was begun in 1998 to promote standards to encourage an environment where fair tax competition can take place. This work resulted in the formulation of standards on transparency and exchange of information, as well as annual assessments of progress regarding implementation of the standards. Important work has also been done to fight aggressive tax planning and corruption, to increase cooperation between tax and anti-money laundering authorities, and to facilitate tax collection assistance.[269]

Ernick also examines the OECD's work on aggressive tax planning, which is directed at helping authorities 'identify and respond to tax risks, and to share country experiences and responses in dealing with aggressive tax planning'.[270] Ernick states that the goal of the work on aggressive tax planning is to 'enable countries to identify new schemes more quickly, and to provide countries with the tools to modify their risk management strategies and develop successful legislative or administrative countermeasures'.[271] The OECD also provides a forum for countries to exchange information on tax planning schemes, detection methods, and response strategies. The Aggressive Tax Planning ('ATP') Expert Group is a sub-group of Working Party No. 11 responsible for maintaining and updating a secure directory of aggressive tax planning schemes submitted by member countries.[272]

Access to the ATP Directory database is limited to government officials from countries that are members of the Expert Group on the ATP Directory. As of 21 February 2017, the Directory contained a database of

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[269] Ibid.

[270] Ibid 3. In the aftermath of the 2008 financial crisis and the 2010–2012 Eurozone sovereign debt crisis, however, there is increasing concern that governments are losing substantial corporate tax revenue because of sophisticated tax planning aimed at shifting income to low-tax jurisdictions. The issue has become highly politicized, and as budgets for social services are cut and austerity measures contemplated…

[271] Ibid. Questions have been raised as to whether existing tax rules, designed in an era of lower economic integration and characterized by more reliance on fixed assets and equipment, have kept pace with a rapidly globalizing economy characterized by a high degree of economic integration, global supply chains, greater ease of doing business across borders without physical presence through e-commerce, and increasing reliance on intangibles and services as value drivers.

[272] 'Co-operation and Exchange of Information on ATP', *OECD* (Web Page) <http://www.oecd.org/ctp/aggressive/co-operation-and-exchange-of-information-on-atp.htm>. A review undertaken by the Secretariat in 2012 showed that the information on the directory had assisted some countries to avoid substantial potential revenue loss (up to EUR 1.5 billion) through the early identification of previously unknown ATP schemes.

The Directory is maintained by a sub-group of the members of Working Party No. 11 that adhere to certain confidentiality undertakings and agree to make an active contribution to the ATP directory.

Directory data has formed the basis for 6 published reports that have been instrumental in contributing to the policy debate at an international level. Recent projects include reports on corporate losses in the banking sector and beyond, on disclosure initiatives and on hybrid mismatch arrangements.

more than 400 tax planning schemes and a section on hybrid mismatches with tables that compare the tax treatment of entities and instruments in various countries to facilitate the detection of *hybrid mismatch arrangements.*[273] The purpose of the ATP Directory is to provide a database to share information on aggressive tax planning for access by government officials from member countries. This process assists member countries to identify, analyse, and understand new aggressive tax planning techniques, facilitate their detection, rapidly adapt risk management strategies, and formulate appropriate legislative and administrative responses.[274]

Information provided on the OECD website reveals that according to a review undertaken by the Secretariat in 2012, information available on the ATP Directory had assisted some countries to avoid substantial potential revenue losses (up to EUR 1.5 billion) through the early identification of previously unknown ATP schemes. Data extracted from the ATP Directory has formed the basis for six published reports that have been instrumental in contributing to the policy debate at an international level. Recent projects include reports on corporate losses in the banking sector and beyond, reports on disclosure initiatives, and reports on hybrid mismatch arrangements.[275]

The role assumed by the OECD in international taxation is broad and encompasses all major areas of tax treaties, tax policy, cooperation, planning, controversy, dispute resolution and administration.

3.3 Model Tax Convention on Income and on Capital

The Model Convention first came into force as the result of work carried out by the Fiscal Committee of the OECD between 1958 and 1961. The Committee's final report *Draft Double Taxation Convention on Income and Capital*[276] was considered and revised and finally published in 1977 as a new Model Convention and Commentaries.[277] The factors that prompted the OECD to develop the new Model Convention and

[273] Ibid paragraph 2. Directory data has formed the basis for 6 published reports that have been instrumental in contributing to the policy debate at an international level.

[274] Ibid paragraph 3.

[275] Ibid paragraph 6.

[276] Jeffrey Owens and Mary Bennett, 'OECD Model Tax Convention - Why It Works' (2008) Volume 2008, Issue 4 *OECD Observer* <http://oecdobserver.org/news/archivestory.php/aid/2756/OECD_Model_Tax_Convention.html>.

'Can the OECD Model Tax Convention, which is 50 years old this year, continue to fulfill its role of helping to make international taxation fairer and more manageable? Probably yes, though there are challenges.'

Half a century ago, the Fiscal Committee of the Organisation for European Economic Co-operation (OEEC), which later became the OECD, published a first draft instalment of how a model treaty on international taxation might look. The global economy was starting to become more integrated in the 1950s and the intention was to assist businesses and governments by helping to avoid double taxation and to prevent tax evasion. The question to resolve was straightforward enough: how might governments claim their rightful taxation from growing international businesses, while not leaving corporations worried about being unfairly taxed across the different jurisdictions in which they operate"?

[277] OECD, *Model Double Taxation Convention on Income and on Capital* (OECD Publishing, 1977).

Commentaries continued, as did the pressures to update and adapt the 1977 Model to changing economic conditions.[278]

Globalisation and the liberalisation of OECD economies accelerated rapidly in the 1980s, thereby exerting pressure on the CFA to examine various issues related to the 1977 Model Convention. This culminated in the publication of a revised version of the Model Convention, updated to embrace the concept adopted by the CFA of an 'ambulatory Model Convention providing periodic and more timely updates and amendments without waiting for a complete revision'.[279]

The international tax treaty network is based mainly on the Model Convention that was first published by the OECD in 1977 and adopted many of the features of the double tax agreements developed by the League of Nations in the 1920s. Although initially successful, the Model has since 1991 received increasing criticism for its failure to deal adequately with the recent developments referred to in Chapter 2 of this thesis, particularly the proliferation of MNEs and globalisation that have combined to produce the digital economy.

There appears to exist a subtle difference between the views of the OECD and the wider international tax community on the causes of base erosion and profit shifting. The Executive Summary of the 2013 report *Addressing Base Erosion and Profit Shifting,* for example, stated:[280]

> While there clearly is a tax compliance aspect, as shown by a number of high-profile cases, there is a more fundamental policy issue: the international common principles drawn from national experiences to share tax jurisdiction may not have kept pace with the changing business environment. Domestic rules for international taxation and internationally agreed standards are still grounded in an economic environment characterised by a lower degree of economic integration across borders, rather than today's environment of global taxpayers, characterised by the increasing importance of intellectual property as a value-driver and by constant developments of information and communication technologies.[281]

By way of further example, the Executive Summary explains:

> Interaction of domestic tax systems (including rules adopted in accordance with international standards to relieve double taxation), however, can also lead to gaps that provide opportunities to eliminate or significantly reduce taxation on income in a manner that is inconsistent with the policy objectives of such domestic tax rules and international standards.[282]

The Executive Summary, somewhat cautiously, further reports:

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[278] *Model Tax Convention 2014* (n 9) 1-1.

[279] Ibid 1-3.

[280] *Addressing Base Erosion and Profit Shifting* (n 23).

[281] Ibid 5.

[282] Ibid 5.

> This report also shows that current international tax standards may not have kept pace with changes in global business practices, intangibles and the development of the digital economy.[283]

The OECD in the *Background to the BEPS Action Plan* allocated responsibility for BEPS to the design of domestic tax rules:

> Taxation is at the core of countries' sovereignty, but the interaction of domestic tax rules in some cases leads to gaps and frictions. When designing their domestic tax rules, sovereign states may not sufficiently consider the effect of other countries' rules. The interaction of independent sets of rules enforced by sovereign countries creates frictions, including potential double taxation for corporations operating in several countries.[284]

In the Executive Summary, the OECD report again ascribes responsibility to domestic laws for the increase of BEPS:

> More fundamentally, a holistic approach is necessary to properly address the issue of BEPS. Government actions should be comprehensive and deal with all the different aspects of the issue. These include, for example, the balance between source and residence taxation, the tax treatment of intragroup financial transactions, the implementation of anti-abuse provisions, including CFC legislation, as well as transfer pricing rules.[285]

A different view of the international tax environment was adopted by Professor Richard Vann in 1991 when he identified the following issues as 'plaguing' the 1977 OECD Model Tax Treaty: [286]

- The OCED Model adopts separate taxation of corporate groups across national boundaries rather than consolidated group taxation.[287]
- The scheduler structure of tax treaties with different types of income encourages taxpayers to recharacterise income to obtain the best tax result.[288]

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[283] Ibid 7.

[284] *Action Plan on Base Erosion and Profit Shifting* (n 25).

[285] *Addressing Base Erosion and Profit Shifting* (n 23) 7.

[286] Vann (n 4). Page numbers in the original publication are indicated in square brackets. Some minor corrections of layout and typographical errors have been made. (Author's note).

[287] The courts are loath to spell out any clear policy that will detract from the separate legal personality of each corporation so strongly established in the common law at the turn of the century. See, eg, *Salomon v Salomon & Co* [1897] AC 22; see also *Walker v Wimborne* (1976) 137 CLR 1, *Industrial Equity Ltd v Blackburn* (1978) 137 CLR 567, compare *D.H.N. Food Distributors Ltd v Tower Hamlets Borough Council* [1976] 1 WLR 852; the issue is discussed in H.A.J. Ford, *Principles of Company Law* (Butterworths, 4th edition, 1986) 131–139; L.C.B. Gower, *Modern Principles of Company Law* (Stevens, 4th edition, 1979) 117–133.

[288] Ibid. 'The problem is made worse by the requirement of reciprocity in tax treaties even where the tax systems of the treaty partners are quite different and effective reciprocity is not achieved by formal reciprocity. These difficulties are most acute in the corporate group and similarly the practice of treaty shopping through the use of conduit corporations is caused by the separate taxation of the members of a group.'

- The arm's length standard adopted in tax treaties for transfer pricing adjustments between related parties may have been appropriate in the 1930s when it was formulated, but the growth of transnational corporate groups and the increasing economic interdependence of their parts mean that both at the theoretical and administrative level the test is no longer workable.[289]
- The Model does not deal directly with issues such as thin capitalisation and the use of tax havens.
- The OECD Model is increasingly inefficient as it treats different categories of income differently and thereby encourages the recharacterisation of income.

Vann proposes that in view of the shortcomings of the Model Convention, a multilateral treaty or treaties may be appropriate for the Asia-Pacific region:

- A multilateral treaty akin to that suggested above for the Pacific Island states could then be generalised to the region for those cases where bilateral arrangements were not yet in place (which in the case of this region provides substantial room), and next regional bilateral arrangements could progressively be replaced by the multilateral treaty, which would be an evolving instrument.[290]

Vann further proposes that the Asia-Pacific region should adopt: 'a multilateral, institutional rather than a bilateral, textual mode for international tax change'.[291]

Professor Ring of Boston College Law School is another tax expert who acknowledges that whilst the possibility of an MTT has been raised by tax experts, there has been no flow-on, mainly because of feasibility concerns.[292] Ring favours an MTT and believes it may be possible to achieve this by a 'strategically designed process [that] can lead nations to a level of interaction and substantive discourse that might be impossible to achieve at the outset'.[293]

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[289] Ibid. The alternative of formulary apportionment probably requires a multilateral framework since it is necessary for all countries to agree on an international tax base and formulas to allocate taxing rights to different countries. Hence the bilateral tax treaty network is reaching an impasse in the transfer pricing area.

[290] Ibid.

[291] Ibid.

[292] Ring (n 107). See also Thuronyi (n 47); Rödler (n 47); Daniel Berman, Part I: 'Departing U.S. Treasury Staffer Discusses Treaties'(1997) 15 *Tax Notes International* 949, 951 (quoting departing Deputy International Tax Counsel Daniel Berman, 'It has not proven practical to have a multilateral tax treaty ... because the tax systems in each country have a lot of differences that you have to reflect in a bilateral negotiation.'); Pressler (n 47) (Senator Larry Pressler's Senate floor statement noting concerns in the tax context that 'countries find it much more difficult to reach agreement on a common goal .... The interests of each nation result in unique approaches to the determination of revenue requirements, the ability to raise taxes and indeed, to the kinds of taxes upon which its system will depend.').

[293] Ring (n 107) 1707. The proposal for multilateral cooperation starts with treaty reform (templates followed by multilateral treaties) and considers focused topical agreements as a subsequent possibility once the procedural framework and treaty reforms are in place. However, it might be possible, and perhaps preferable, to reverse the order. To the extent that part of the serious impetus for treaty reform comes from the substantive areas where solutions demand multilateral attention, perhaps we should start with multilateral agreements limited to these prominent topics. If significant political will proves necessary to initiate a multilateral treaty process, then it may make sense to direct that energy and attention not to the general operation, maintenance, and development of the treaty network, but instead to the specific questions and problems most likely to undermine the

Professor John Taylor of the University of New South Wales questioned the sustainability of bilateral double treaty networks in a 2010 article published by the Melbourne University Law Review.[294] Taylor identified the relative slowness of bilateral double treaty networks to respond to changes in tax policy and economic conditions as the major problem with the current international tax treaty network. It is arguable that this problem has been intensified by the operation of the MLI in that each treaty must be examined to ascertain which provisions apply in view of the operation of the optional provisions:

> This is a product of the very bilateral nature of double taxation treaties. Each treaty must be negotiated and re-negotiated separately, with variations being made according to economic and political considerations relevant to the bilateral relationship.[295]

Professor Reuven Avi-Yonah of the University of Michigan Law School questions why double tax treaties are bilateral rather than multilateral and concludes that this is because the models on which the OECD Model is based were developed before World War II when bilateral treaties 'were the norm'.[296] Avi-Yonah further suggests that the time may be at hand to try to negotiate an MTT, especially given the difficulty double tax treaties face when dealing with 'triangular cases' involving third countries. Avi-Yonah also argues that tax laws have converged a lot since the 1920s and multilateral treaties are now the norm so that a renewed effort to negotiate such an MTT (perhaps in the WTO context) seems to be called for.[297]

Professor Marjaana Helminen of Helsinki University is another tax expert who believes an MTT can more effectively counter BEPS than the current bilateral treaty network.[298] Helminen proposes that the Nordic MTT be adopted as the model for a European multilateral model tax treaty. Helminen argues that bilateral tax treaties do not eliminate all international double taxation and other international tax law problems. She advances that although most of the bilateral tax treaties of the EU Member States are based on the OECD Model, they differ in detail.[299]

Helminen further advances that these differences in detail generate different tax treatments of different bilateral interactions. She argues that the tax consequences arising from one bilateral treaty will differ from those arising from another. Helminen suggests that a multilateral treaty would provide for the allocation of

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international tax system in the near future. The recent efforts of the OECD regarding tax competition indicate the plausibility of an issue-focused approach.

294 John Taylor, 'Twilight of the Neanderthals, or Are Bilateral Double Taxation Treaty Networks Sustainable?' (2010) 34 *Melbourne University Law Review* 268.

295 Ibid.

296 Reuven Avi-Yonah, 'Double Tax Treaties: An Introduction' in Karl Sauvant and Lisa Sachs (eds), *The Effect of Treaties on Foreign Direct Investment: Bilateral Investment Treaties, Double Taxation Treaties and Investment Flows* (Oxford University Press, 2009) 15.

297 Ibid.

298 Helminen (n 92).

299 Ring (n 107).

taxing powers regarding cross-border flows of income and capital within the European Union and would eliminate many of the problems associated with bilateral treaties, which are restricted to the two states that are signatories to each treaty.[300] She argues that a multilateral treaty would function to eliminate international double taxation and EU law infringements not only in bilateral relations but also where more than two countries have a taxing interest in the same situation. She suggests that an MTT would ensure uniformity in the tax treatment of all intra-EU cross-border situations.[301]

Finally, Helminen argues that a multilateral EU tax treaty would abolish base erosion and profit shifting by means of intra-EU treaty shopping and would eliminate the competitive advantages and disadvantages bilateral treaties encourage through discrepancies in respective bilateral treaties and corresponding domestic laws. Helminen proposes that a multilateral EU tax treaty could resolve many of the international tax law problems not resolved by the bilateral tax treaties concluded by the EU Member States. She concludes that a multilateral EU tax treaty would ensure tax coordination to eliminate double taxation and other direct tax problems in intra-EU cross-border situations.[302]

The 21st century provides a different business environment to that in 1928, when the first double tax model was developed, or 1977, when the Model Convention was first published. Attempting to apply outdated bilateral treaty concepts to the delivery of digital goods and services will become increasingly difficult as the modern financial world moves further away from 1977.[303] The digital economy is dominated by large economic systems, often structured *ab initio* on tax-effective business models.[304] These businesses employ computer programs that automatically capture customers/users through Internet Protocol-tracking techniques, exploit relationships so established by offering new products and services, employ extensive use

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[300] Ibid.

[301] Ibid.

[302] Ibid.

[303] Michael Devereux and John Vella, 'Are We Heading towards a Corporate Tax System Fit for the 21st Century'? (2014) 35(4) *Institute for Fiscal Studies* 1.

Professors Deveraux and Vella of Oxford University Centre for Business Taxation are of the view that "The most significant problems with the existing system for taxing the profit of multinational companies stem from two related sources. First, the underlying '1920s compromise' for allocating the rights to tax profit between countries is both inappropriate and increasingly hard to implement in a modern economics setting. Second, because the system is based on taxing mobile activities, it invites countries to compete to attract economic activity and to favour 'domestic' companies.

[304] Rajendra Nayak, 'Addressing the tax challenges of the digital economy: OECD's Action Plan on Base Erosion and Profit Shifting (BEPS)' (2013) *EY Tax Alert* 1 <http://www.ey.com/Publication/vwLUAssets/EY_Tax_Alert_-_BEPS_ActionPlan_Digital_Economy_RN/$File/EY-BEPS-ActionPlan-Digital-Economy-RN.pdf>.

'The dominant players in the digital economy are large "ecosystems" who base their business model on radically new paradigms – for example, privileged relationship with customers/users, exploit existing relationships by entering into new sectors, extensive use of digital technologies and constant innovation, optimize exploitation of data collected from their users, capability to generate "traction", i.e. fast development of the user base'.

of digital technologies, and reinvest profits in ongoing innovation and development of new products.[305] The trading structure remains relatively static as their activity is by and large 'intangible' and does not require significant business restructuring actions to adapt their models as they evolve.

In an era where non-resident taxpayers can derive substantial profits from transacting with customers located in another country, questions are raised on whether the current rules serve the intended purpose for which they were designed. Further, as businesses increasingly integrate across borders and tax rules often remain uncoordinated, opportunities exist for these multinationals to employ technically legal structures that take advantage of dissimilarities in domestic and international tax rules to minimise corporate tax.[306]

Professor Dale Pinto of Curtin University examined the options available to countries in addressing the challenges to corporate tax revenue raised by the ongoing expansion of the digital.[307] In response to Action 1 of the OECD's Action Plan on Base Erosion and Profit Shifting, Pinto advanced the opinion that 'in many ways, the digital economy does not really represent anything new'.[308] Pinto identified and summarised the following features of the digital economy which he considered relevant for tax purposes:

Mobility

According to Pinto, the digital economy is responsible for increased mobility in relation to intangibles (defined by the Oxford Dictionary as 'Unable to be touched; not having a physical presence'), users and business functions. He characterises intangibles as a 'core contributor to value creation and economic growth for companies that operate in the digital economy…[that] provides an easy, accessible and quick platform' for digital corporations to deal with these 'intangible' assets in ways to minimise tax.[309]

Pinto further suggests that users in general, and particularly businesses, can 'increasingly access remote markets more easily with minimal (or no) personnel'.[310]

Reliance on data

The digital economy relies heavily on data collection and storage facilitated by increasing computer power and storage capacity.[311]

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[305] Ibid.

[301] *Addressing Base Erosion and Profit Shifting* (n 23) 25.

[307] Pinto, 'A Preliminary Analysis' (n 75). See also Pinto, 'The Continued Application of Source-Based Taxation' (n 74).

[308] Pinto, 'A Preliminary Analysis' (n 75) 7–9.

[309] Ibid.

[310] Ibid 9.

[311] See also OECD, 'Addressing the Tax Challenges of the Digital Economy – Fundamental principles of taxation' (OECD/G20 Base Erosion Profit Shifting Project, 16 September 2014) < https://www.oecd.org/ctp/addressing-the-tax-challenges-of-the-digital-economy-9789264218789-en.htm> ('Addressing the Tax Challenges of the Digital Economy').

Network Effects

This means essentially that users' decisions may have a direct impact on the 'benefit received by other users'.

Multi-sided business models

Employ hybrid mismatch arrangements to create gaps and frictions between treaties and domestic tax laws thereby creating opportunities for tax avoidance.

Monopoly or oligopoly

Business models relying heavily on network outcomes tend towards monopoly or oligopoly.

Volatility

Low entry barriers and evolving technology produce volatility.

In 2014, the OECD published the report *Addressing the Tax Challenges of the Digital Economy,* which included several key observations regarding reasons for the advent of the digital economy, the continuing evolution of the digital economy, the fiscal effects of the digital economy, how to deal with it, and predictions for future developments.[312] The report's executive summary contains this concise definition of the digital economy: 'The digital economy is the result of a transformative process brought by information and communication technology (ICT)'.[313]

The ICT revolution has made technologies more integrated, cheaper and, therefore, more available, more powerful, and widely standardised.[314] These characteristics streamline business processes and stimulate innovation across all sectors of the economy. Examples of this new technology in operation include:

- Purchase orders for goods and services can be placed online.
- The broadcasting and media industry has been substantially expanded and revolutionised with news, current affairs, and a raft of other programs available 24 hours per day, seven days per week.
- Automation enables a multitude of functions, previously only available through human involvement, to be accessible online without any human involvement.
- Customer services that previously required human involvement are now available online via automation in the form of recorded messages and information without any human involvement.
- Media from non-traditional news sources and expanding user participation in media are made possible through user-generated content and social networking.[315]

[312] Ibid.

[313] Ibid 11.

[314] Ibid 12–16.

[315] Ibid 11, 52–60.

The digital economy has revolutionised global business, and, to date, the Model Convention has failed to keep pace with the speed of development of the digital economy and the increasing incidence of BEPS.[316]

In addition to the 27 articles comprised in the Model Convention, it is accompanied by an extensive Commentary, prepared by the OECD Committee on Fiscal Affairs.[317] The question of how the Commentaries fit into the rules on treaty interpretation contained in the *Vienna Convention on the Law of Treaties* must be determined by each country according to its laws.[318] The Australian Taxation Office, for example, takes the position that the Commentaries 'provide important guidance on interpretation and application of the OECD Model and as a matter of practice will often need to be considered in interpretation of DTAs, at least where the wording is ambiguous, which […] is inherently more likely in treaties than in general domestic legislation'.[319] Each country has its own assessment of the interpretative value of the Commentaries.[320] Frequent changes [to tax commentaries] also undermine the authority of the OECD Commentary for interpretation purposes because it may be unclear on which Commentary version a certain double taxation convention is based.[321]

The recent OECD work on the BEPS Action Plan, and more particularly on the Multilateral Convention,[322] is a strong indication that in circumstances where countries recognise a shared issue that requires difficult and careful incremental work, they are prepared to jointly work toward a resolution, even where extensive multilateral cooperation is necessary.

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[316] Ibid.

[317] Ibid.

[318] See Michael Lang and Florian Brugger, 'The Role of the OECD Commentary in Tax Treaty Interpretation' (2008) 23 *Australian Tax Forum* 108.

[319] ATO TR 2001/13, para 104.

[320] See, eg, *Thiel v. FC of T* (1990) 90 ATC 4717, 4727 and 4720.

In Thiel, the High Court judges all accepted that the OECD Model Taxation Convention's official Commentaries may be relevant to the interpretation of double tax agreements (DTAs) based on the OECD Model. McHugh J (with whom the majority agreed in their joint judgment) approved recourse to the OECD Model and Commentaries under Article 32 of the *Vienna Convention* (that is, as supplementary means only available for consideration when there is ambiguity or the like, or to confirm a meaning reached by examining Article 31 materials).

[321] See Lang and Brugger (n 318) 108. See also Klaus Vogel, 'The Influence of the OECD Commentaries on Treaty Interpretation' (2000) 54(12) *IBFD* 614; P Wattel and O Marres, 'The Legal Status of the OECD Commentary and Static orAmbulatory Interpretation of Tax Treaties' (2003) 43(7) *European Taxation* 228; M Waters, 'The relevance of the OECD Commentaries in the interpretation of Tax Treaties' in M. Lang and H. Jirousek (eds), *Praxis des internationalen Steuerrechts – Festschrift für Helmut Loukota zum 65. Geburtstag* (Linde Verlag, 2005) 679.

[322] OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*, opened for signature on 7 June 2017 (entered into force on 1 July 2018) <https://www.oecd.org/tax/treaties/multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-beps.htm> ('*Multilateral Convention to Prevent BEPS*').

3.4 OECD/G20 BEPS Action Plan

The increasing failure of the international tax treaty network based on the OECD Model Convention to reduce tax avoidance by multinationals, more commonly called BEPS, required the OECD to action to address this problem. On 5 October 2015, the OECD published 13 Final Reports and an explanatory statement outlining consensus actions under the BEPS Project.[323] These reports contain the OECD's response to BEPS and are of paramount importance to countries struggling to raise sufficient tax revenue to fund general expenses and their extensive social programs.

The 15 Actions may be summarised as follows:

Action 1

The goal of Action 1 is to identify the challenges the digital economy poses to international taxation. It also aims to develop options to address these. This applies to not only direct taxes, like corporate taxation, but also indirect taxes, like Value Added Taxes and Custom Duties.

Action 2

Hybrid mismatch arrangements focus on the differences in the tax treatment of an entity or a financial instrument under the laws of two or more countries. An example of a hybrid mismatch arrangement is a hybrid entity. Such an entity is regarded as 'tax transparent' in one country and 'non-tax transparent' in another country. The use of such an entity in a corporate structure can offer opportunities to avoid taxation on certain income. Develop anti-avoidance rules.

Action 3

Controlled Foreign Company ('CFC') rules lead to the taxation of income of controlled foreign subsidiaries in the hands of resident shareholders if certain conditions are met. For example, CFC rules can test whether a subsidiary is based in a low-tax jurisdiction and if it earns passive income.

Action 4

Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example, through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income and other financial payments that are economically equivalent to interest payments.

Action 5

[323] 'BEPS 2015 Final Reports' (n 27)

Re-evaluate the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime.

Action 6

Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances.

Action 7

Develop changes to the definition of permanent establishment ('PE') to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues.

Action 8

Develop rules to prevent BEPS by moving intangibles among group members.

Action 9

Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members.

Action 10

Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties.

Action 11

Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis.

Action 12

Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules.

Action 13

Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business.

Action 14

Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.

Action 15

Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed during the work on BEPS and amend bilateral tax treaties.[324]

To address the individual Actions, the OECD established various working parties and task forces. The Australian Taxation Office and the Treasury represented Australia on many of these, including in the:

- Working Party 1 on Tax Conventions and Related Questions (focus on treaty abuse, artificial avoidance of permanent establishment status and dispute resolution);
- Working Party 2 on Tax Analysis and Statistics (establish methodologies to collect and analyse data on BEPS and actions to address it);
- Working Party 6 on the Taxation of Multinationals (includes work on hand to value intangibles and cost contribution arrangements, financial transactions including loans and transfer pricing documentation);
- Working Party 9 on Consumption Taxes;
- Forum on countering harmful tax practices more effectively;
- Working Party 10 on the Exchange of Information and Tax Compliance; and
- Working Party 11 on Aggressive Tax Planning (includes work on hybrid mismatch arrangements, controlled foreign companies, interest deductions and other financial payments and mandatory disclosure rules).[325]

The press release by the OECD on 24–25 November 2016 revealed that more than 100 countries had finalised negotiations on a multilateral instrument called *The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS*.[326] The Convention is designed to amend the existing global tax treaty network to incorporate the results from the OECD/G20 Base Erosion and Profit Shifting Project. A signing ceremony was held in Paris in June 2017.[327]

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[324] *Action Plan on Base Erosion and Profit Shifting* (n 25).

[325] Treasury (Cth), ‘Australia's Adoption of the OECD BEPS Convention (Multilateral Instrument)’ (Consultation Paper, 19 December 2016).

[326] OECD, ‘Press Release, 24-25 November 2016’.

[327] Ibid.

The OECD argues that the Convention will implement minimum standards to counter treaty abuse and improve dispute resolution mechanisms. It also contends that the Convention will provide flexibility to accommodate specific tax treaty policies and allow governments to strengthen their tax treaties with other tax treaty measures developed in the OECD/G20 BEPS Project.[328]

The OECD/G20 BEPS Project press release disclosed that the OECD hopes to reduce BEPS by closing the gaps in existing international rules that allow the profits of multinationals to 'disappear' or to be artificially shifted to low- or no-tax jurisdictions, where the multinationals carry out little or no economic activity. The OECD reported that over 100 countries and jurisdictions were working in the Inclusive Framework on BEPS to implement BEPS measures in their domestic legislation and treaties.[329]

The OECD is the repository of the multilateral instrument and supports governments with its signature, ratification, and implementation. A first high-level signing ceremony took place in the week beginning 5 June 2017, with the participation of a significant group of countries during the annual OECD Ministerial Council meeting, which brings together ministers from OECD and partner countries to discuss issues of global relevance. According to the OECD, the new Convention reduces the time and effort spent addressing base erosion and profit shifting.[330] While this may be so, this thesis argues that it is, however, unlikely, given that the bilateral treaty network will continue to expand and that multinationals will continue to find new opportunities for BEPS.

3.5 The Multilateral Convention to Implement Tax Treaty-Related Measures to Prevent Base Erosion and Profit Shifting

The Multilateral Convention is arguably the most important outcome of the OECD/G20 Project. This project resulted in the BEPS Action Plan that was developed by the OECD Committee on Fiscal Affairs and endorsed by the G20 Leaders in September 2013.[331]

Australia is widely regarded as a global leader in BEPS implementation and has actively participated in the development of the Multilateral Convention.[332] On 26 November 2016, two days after the release by the OECD, the Minister for Revenue and Financial Services released a statement.[333] According to the Minister, the Convention represents another significant step in the global fight against multinational tax avoidance and

[328] Ibid.

[329] Ibid.

[330] *Multilateral Convention to Prevent BEPS* (n 322).

[331] OECD, Committee on Fiscal Affairs, *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (OECD Publishing, 2016).

[332] Deloitte, Touche, Tohmatsu Limited, (Deloitte), 'BEPS: OECD Multilateral Convention' (8 December2016) *Tax Insights*.

[333] The Honourable Kelly O'Dwyer, MP, Minister for Revenue and Financial Services, 'OECD Finalises New Multilateral Convention on Tax Aavoidance' (Media Release, 26 November 2016).

the completion of the final action of the OECD/G20 BEPS Project. Treasury released a discussion paper on the Convention.[334]

In December 2016, the Australian Government released a Consultation Paper on Australia's adoption of the Multilateral Convention.[335] The Convention is a process developed by the OECD to quickly implement the tax treaty-related measures arising from the BEPS Action Plan. This includes minimum standards on treaty abuse (Action 6) and improving dispute resolution (Action 14). The Convention also includes articles on PE (Action 7) and hybrid mismatches (Action 2).

The Convention supports all previously agreed BEPS approaches by allowing jurisdictions to select from alternative options, which they will do by filing reservations. Changes to the operation of double tax treaties are always prospective and subject to jurisdictions signing up to and ratifying the Convention. The Convention does not address any domestic law changes in respect of BEPS. The Convention has been open for signature since 31 December 2016.[336]

The Convention is restricted to treaties wholly or partly relating to taxes on income and is not intended for shipping, air transport or social security agreements. Some of the BEPS Report recommendations contained tax treaty-specific measures that were included in the 2017 update of the OECD *Model Tax Convention on Income and on Capital*, for example:

- BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements
- BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances
- BEPS Action 7: Preventing the Artificial Avoidance of Permanent Establishment Status
- BEPS Action 14: Making Dispute Resolution Mechanisms More Effective[337]

The policy intent of these measures has been incorporated into the Convention.[338]

Overview

Scope of Convention and Treaties

Article 1 defines the scope of application of the Multilateral Convention and modifies all Covered Tax Agreements as defined in Article 2(1)(a).[339]

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[334] Treasury (Cth) (n 30).

[335] Ibid 2.

[336] *Developing a Mulitlateral Instrument* (n 26).

[337] Ibid 2.

[338] Ibid.

[339] Ibid.

Countries will provide the OECD Depositary with a list of the double tax treaties they wish to modify under the Convention (so-called 'Covered Tax Agreements' or 'CTAs'). A bilateral treaty will be modified only if both parties to it agree to do so.[340]

Function

The Convention does not function in the same way as an amending protocol to an existing bilateral treaty. It does not directly change the underlying text. The Convention will be applied 'alongside' the existing treaty with the intention of 'modifying' its application to BEPS matters. Countries are free to prepare 'combined' versions of treaties, but there is no requirement for this action.

Definition of Terms

The term 'Covered Tax Agreement' means an agreement in force between two or more countries for the avoidance of double taxation with respect to taxes on income (regardless of whether other taxes are also covered).

Adoption Choices

The Convention includes flexible features designed to attract countries by permitting them to tailor their adoption to fit their national circumstances and accommodate their unique treaty network. This is intended to be achieved through devices such as notifications, article choices, specific paragraph options, and reservations. Each country is required to enter their set of choices at the time of signing and confirm them at the time of ratification.[341]

Adopting jurisdictions will be required to nominate which of their bilateral tax treaties they want the Convention to apply to and modify. By omission, jurisdictions can exclude treaties from the scope of the Convention. Treaties that are brought within the scope of the Convention are referred to as 'Covered Tax Agreements' or 'CTAs'.[342] If only one jurisdiction (or neither jurisdiction) identifies a bilateral treaty as a CTA, the provisions of that treaty will remain unmodified.[343]

Depositary

The Secretary-General of the OECD is appointed the Depositary of this Convention and any protocols pursuant to Article 38 (Relation with Protocols). The duty of the Depositary is to receive CTAs and to perform various management functions.[344]

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[340] Deloitte (n 332) 2.

[341] Commonwealth of Australia (n 330) 2.

[342] Ibid 2.

[343] Ibid.

[344] *Multilateral Convention to Prevent BEPS* (n 322).

There is no obligation for a jurisdiction to list all tax treaties as CTAs, and jurisdictions are free to pursue bilateral negotiations instead. Countries can list a subset of treaties where they wish to adopt a different position for that subset to that generally adopted by that country under the Convention.[345]

Most of the Convention Articles are optional, although some are mandatory. Jurisdictions can choose to adopt the minimum standards only or they can adopt some or all of the optional Articles. The Convention ensures that all CTAs comply with the BEPS minimum standards. The Convention also provides for governments to strengthen their tax treaties with other optional BEPS measures that do not form part of the minimum standard.[346]

The Convention incorporates significant flexibility to accommodate specific tax treaty policies and ensure that the Convention is compatible with as many treaties as possible. Some BEPS recommendations include alternative ways to address an issue or provide for a main provision to be supplemented by an additional provision.[347]

Generally, reservations or choices made by jurisdictions will apply to all CTAs but can be restricted to a subset of its CTAs based on objective criteria. For example, a jurisdiction can restrict changes to residence tiebreaker clauses to apply only to CTAs that already contain a tiebreaker of a specific description.[348]

Transparency

The Convention obligates the OECD to publish the list of jurisdictions' CTAs, together with their reservations and options. The Inclusive Framework on BEPS will review and monitor its members' treaties, as modified by the Convention, to establish compliance with the BEPS minimum standards.[349]

Timetable and entry into effect

The Convention began operating once it was ratified by five jurisdictions. This means that after signature in June 2017, five jurisdictions had to complete their domestic treaty implementation processes before the Convention became effective.

For Australia, the Convention must be legislated and then formally ratified. The Convention took effect in Australia from 1 January 2019 for rules relating to withholding taxes and from 1 July 2019 on rules relating to other taxes, subject to its ratification by Australia's treaty partners.

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[345] Deloitte (n 332) 2.

[346] Commonwealth of Australia (n 330).

[347] Ibid 3.

[348] Deloitte (n 332) 3.

[349] Ibid 3.

The provisions of the Convention are binding and modify existing bilateral treaties in line with both parties' adoption choices once both jurisdictions have ratified it. Jurisdictions retain their sovereign ability to supersede the Convention changes by subsequently concluding a new bilateral agreement.[350]

Hybrid mismatches

While most of the recommendations on hybrid mismatches concern changes to domestic law, optional treaty changes are included in respect of:

- the treatment of fiscally transparent entities;
- the use of competent authority tiebreaking procedures to determine the residence of otherwise dual resident entities; and
- the application of the exemption and credit methods of double tax relief.[351]

Treaty Abuse

Many tax treaties contain specific integrity rules to prevent treaty benefits from being obtained in unintended circumstances. However, some taxpayers circumvent these rules using treaty shopping and other abusive arrangements. Article 7 will modify jurisdictions' bilateral treaties to include the following:

- a general anti-avoidance rule — the Principal Purpose Test ('PPT') — to deny treaty benefits where obtaining the benefit was one of the principal purposes of the arrangement unless granting the treaty benefits would be in accordance with the object and purpose of the relevant provisions of the treaty; and
- a supplementary (and optional) rule — the Simplified Limitation on Benefits rule (S LOB rule) — to grant treaty benefits only to specified 'qualified persons' (individuals, government entities, listed companies, non-profit organisations, pension funds, entities engaged in active business or entities that meet specified ownership requirements).[352]

Permanent establishment

The threshold at which a PE (taxable presence) arises is lowered through:

- broadening the scope of dependent agent PEs (preventing the use of commissionaire arrangements and other matters). This addresses similar arrangements to those targeted by Australia's multinational anti-avoidance law and the UK Diverted Profits Tax;

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[350] Commonwealth of Australia, 'Deposit: Status of List of Reservations and Notifications Upon Deposit of the Instrument of Ratification, Acceptance or Approval' (26 Sep 2018) <https://www.oecd.org/tax/treaties/beps-mli-position-australia-instrument-deposit.pdf>.

[351] Deloitte (n 332) 4.

[352] Commonwealth of Australia (n 330) 13. Article 12 (Convention) deals with artificial avoidance of Permanent Establishment Status through commissionaire arrangements and similar strategies.

- narrowing exemptions for a fixed place of business PEs by requiring activities to be 'preparatory or auxiliary' in character and by introducing an anti-fragmentation rule; and
- countering avoidance where long-duration construction contracts are split into a series of shorter contracts.[353]

Flexibility

The multilateral instrument seeks to provide flexibility by:

1. allowing countries to choose to which tax treaties the convention applies;
2. creating flexibility regarding minimum standards, meaning countries can choose the most suitable option;
3. including the possibility to 'opt out' of provisions that do not relate to a minimum standard;
4. including the possibility to 'opt out' of provisions for treaties with specific, objectively defined characteristics;
5. allowing choices, for example, between the optional provision on mandatory and binding arbitration.[354]

Improving dispute resolution

All CTAs will now include a minimum standard for mutual agreement procedures ('MAP's). If a tax treaty-related case qualifies to be considered under the MAP, upon the request of a taxpayer, the competent authorities are encouraged to seek agreement between themselves on how double tax agreements should apply and implement any agreement.[355]

The Action 14 minimum standard also provides that jurisdictions should provide access to the MAP procedure in transfer pricing cases and should implement the resulting mutual agreements (for example, by making appropriate adjustments to the tax assessed).[356]

Mandatory binding arbitration

New optional mandatory binding arbitration provisions based on the principles set out in the 2015 BEPS recommendations apply only if both parties to a treaty agree. Unlike most other areas of the Convention

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[353] Ibid 21.

[354] Ernst & Young, 'OECD releases multilateral instrument to modify bilateral tax treaties under BEPS Action 15: Executive Summary' (25 November 2016) *Global Tax Alert* <https://eyfinancialservicesthoughtgallery.ie/wp-content/uploads/2017/02/OECD-releases-multilateral-instrument-to-modify-bilateral-tax-treaties-under-BEPS-Action-15-.pdf>.

[355] Commonwealth of Australia (n 313) 28. See also Part V, Articles 16 of the Convention (Mutual Agreement Procedure) and Article 19 which contains the following condition for the application of Article 19 'Where: a) under a provision of a Covered Tax Agreement…'.

[356] *Action Plan on Base Erosion and Profit Shifting* (n 25) 48.

where reservations are standardised, parties are free to determine the scope of cases that will be eligible for arbitration (subject to acceptance by the other relevant parties).[357]

Typically, a taxpayer can request arbitration where a case has been subject to a MAP for at least two years without resolution. The arbitration panel will comprise three arbitrators: the competent authorities nominate one arbitrator each, and the two arbitrators appoint a chair from a third jurisdiction.[358]

Two different types of decision-making processes are facilitated:

- 'final offer' rules, whereby each competent authority presents its own proposed resolutions, and the arbitrators choose their preferred outcome; and
- the 'independent opinion' approach.[359]

3.6 Conclusion

This chapter has briefly examined the current bilateral tax treaty network and extensive BEPS Action Plan modifications that have now become operational. The role of the OECD has also been briefly examined regarding taxation matters in general and, more specifically, regarding the following issues:

1. development of the OECD Model Convention;
2. development of the BEPS Action Plan; and
3. development of the Multilateral Convention.

The efforts of the OECD in developing and implementing the BEPS Action Plan in such a short time are highly commendable, as is the success they have achieved in garnering widespread international cooperation, particularly for the introduction of the Multilateral Convention. In recent times, the OECD has come under sustained pressure from governments struggling to afford their social programs and to resolve the loss of tax revenue through base erosion and profit shifting. Their response to this pressure has been well considered and expeditious. The overall result, however, is an increasingly complicated tax regime into which a greater element of uncertainty has been introduced.

The BEPS Action Plan and the Multilateral Convention are intended as strong countermeasures to the proliferation of tax avoidance activities by multinationals. The international tax regime remains, however, an expanding network of bilateral treaties, each different, each linking sets of domestic rules of varying incompatibility, and with a degree of flexibility that challenges certainty. If the underlying cause of BEPS is the bilateral architecture of the international tax treaty network *per se*, as is argued in the thesis, then the

[357] Ibid 28.

[358] Ibid 29.

[359] Ibid.

BEPS Action Plan in conjunction with the Multilateral Convention (if lawful) risks increasing the complexity of the international tax regime while struggling to achieve its goal of reducing BEPS.

Any assessment of the involvement of the OECD in global taxation affairs must acknowledge that the OECD is funded by 38 countries and that the average corporate tax rate of these countries is 23.04%.

The following chapter is about tax avoidance.

CHAPTER 4: INTERNATIONAL TAX AVOIDANCE

4.1 Introduction

Although this research is concerned with BEPS, this is not the only way that individuals and businesses reduce tax liability. To correctly identify BEPS activities, a brief examination of the various means to reduce tax liability is necessary. The methods commonly employed for this purpose are the use of sham transactions, tax fraud, tax evasion, and tax avoidance.[360]

4.1.1 Sham Transactions

A sham is a false front constructed to disguise the reality of a transaction or state of affairs.[361] The High Court of Australia in *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* stated that 'sham refers to steps which take the form of a legally effective transaction but which the parties intend should not have the apparent, or any, legal consequences'.[362] Taxation Determination TD 21005/34 describes a 'sham transaction' as:

> A sham transaction is essentially a transaction which involves a common intention between the parties to the apparent transaction that it be a disguise for some other and real transaction or for no transaction at all (see *Richard Walter Pty Ltd v. Commissioner of Taxation* (1996) 67 FCR 243; (1996) 96 ATC 4550; (1996) 33 ATR 97).[363]

4.1.2 Tax Fraud

Fraud is a criminal offence, which involves causing harm to an entity (including a jurisdiction) by making a false representation without an 'honest belief in the truth of the representation in the sense in which the representor intended it to be understood'.[364] The Australian Taxation Office ('ATO') is committed to ensuring the integrity of Australia's tax and superannuation system. Preventing, detecting, and responding to

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[360] Robert Deutsch, Mark Friezer, Ian Fullerton, Peter Hanley and Trevor Snape, *Australian Tax Handbook 2017* (Thomson Reuters, 2017) 2037.

[361] Ibid.

[362] *Equuscorp Pty Ltd v Glengallan Investments Pty Ltd* (2004) 57 ATR 556 [46]. 'Each of these transactions was legally effective. None of the transactions that took place on 30 June 1989 could be said to be a sham. The primary judge was wrong to characterise them, as he did by his references to 'artifice', 'façade' and 'charade', as shams. 'Sham' is an expression which has a well-understood legal meaning. It refers to steps which take the form of a legally effective transaction but which the parties intend should not have the apparent, or any, legal consequences. In this case, debts were created and satisfied'.

[363] Australian Taxation Office, *Income tax: what are the results for income tax purposes of entering into a profit washing arrangement as described in Taxpayer Alert TA 2005/1?* (TD 2005/34, 29 July 2009) <https://www.ato.gov.au/law/view/document?DocID=TXD/TD200534/NAT/ATO/00001&PiT=99991231235958#:~:text=A%20sham%20transaction%20is%20essentially,Richard%20Walter%20Pty%20Ltd%20v>.

[364] *Krakowski and Anor v Eurolynx Properties Ltd and Anor* (1995) 183 CLR 563, 578. 'The plaintiffs were induced to enter a contract of sale by a material representation of fact that was false. The representation was that the lease contained the whole of the agreement between the defendant and the tenant. In all the circumstances, that amounted to a representation to the effect that the rent reserved by the lease annexed to the contract of sale was a market rent [emphasis added]. The High Court of Australia considered whether this amounted to fraud and held that fraud was not established'.

fraud and corruption is a critical part of meeting that commitment. Fraud and corruption are potential threats which may affect Commonwealth entities. The ATO treats fraud and corruption seriously and has zero tolerance for such behaviour.

This Fraud and Corruption Control Plan ('The Plan') outlines the ATO's approach to managing fraud and corruption risks and complies with the requirements of Section 10 of the *Public Governance, Performance and Accountability Rule 2013* and Commonwealth Fraud Control Framework 2017. It documents at a high level the strategies the ATO uses to prevent, detect, and respond to internal and external fraud and corruption and is reviewed annually to ensure the ATO is responsive to the changing risk landscape and addresses areas of concern. All ATO staff and contractors play a critical role in the ATO's fraud control arrangements. All cases of suspected fraud and corruption must be reported. The Plan details the channels through which internal and external fraud or corruption can be reported and where to seek additional information.

The Plan is intended to be a tool to support ATO staff in the prevention and detection of fraud and corruption and response to it. Further, it ensures the highest levels of integrity are maintained in Australia's tax and superannuation system.[365]

4.1.3 Tax Evasion

Tax planning and tax evasion are 'mutually exclusive concepts as tax evasion is a deliberate failure to report taxable income accurately, for example by intentionally omitting assessable income or by exaggerating deductions'.[366] The threshold for an opinion of evasion is not as high as fraud. A taxpayer's behaviour may not constitute fraud but be nevertheless sufficiently blameworthy to constitute evasion.

'Evasion' is best explained by reference to Dixon J's judgment in *Denver Chemical Manufacturing v Commissioner of Taxation*[367] ('Denver') in which his Honour noted it would be unwise to attempt to define the word 'evasion' but nevertheless suggested a 'blameworthy act or omission on the part of the taxpayer' be contemplated.

The High Court's guidance from Denver as to what constitutes evasion, including the notion that some blameworthy act or omission is contemplated, has been applied by the Federal Court and State Supreme Courts ever since. An opinion of evasion is a serious matter. It requires the culpable conduct of the taxpayer.

The notion of a 'blameworthy act or omission' lies somewhere between an innocent mistake and the intention to defraud and usually involves a taxpayer making a wrong statement or taking an incorrect position without a credible explanation. 'Culpable conduct' is something more than mere avoidance or the

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[365] Australian Taxation Office, *ATO Fraud and Corruption Control Plan 2020-2021* <https://www.ato.gov.au/General/The-fight-against-tax-crime/In-detail/ATO-Fraud-and-Corruption-Control-Plan-2020-21>.

[366] Deutsch et al (n 360) 2037.

[367] *Denver Chemical Manufacturing v Commissioner of Taxation* (1949) 79 CLR 296.

mere withholding of information or supplying misleading information, such as an intention to withhold information from the Commissioner on the basis the Commissioner would likely take a different view of the tax outcome if the relevant act or omission (for example omission to disclose information) had not occurred and instead accurate representations or disclosures had been made.

4.1.4 Tax Avoidance

Collins Legal Dictionary defines 'tax avoidance' as 'the use of legal methods to pay the smallest possible amount of tax'.[368] Whether a transaction involves tax avoidance can only be determined retrospectively, with the benefit of knowing whether the transaction was challenged and, if so, whether it survived the challenge.[369]

This distinction between tax avoidance and tax mitigation was referred to in the Willoughby case, where Lord Nolan stated:

> The hall mark of tax avoidance is that the taxpayer reduces his liability to tax without incurring the economic consequences that Parliament intended to be suffered by any taxpayer qualifying for such reduction in his tax liability. The hall mark of tax mitigation, on the other hand, is that the taxpayer takes advantage of a fiscally attractive option afforded to him by the legislation, and genuinely suffers the economic consequences that Parliament intended to be suffered by those taking advantage of the option.[370]

The OECD identified six key areas of BEPS in its 2013 report *Addressing Base Erosion and Profit Shifting*: profit shifting; hybrid mismatches; electronic commerce; related party schemes; thin capitalisation and harmful preferential regimes.[371]

This chapter examines international tax avoidance, commonly referred to as base erosion and profit shifting (BEPS), and the foremost anti-avoidance measures developed and employed to counter these practices. This recent focus on international tax avoidance followed the fiscal constraints imposed on European countries by the Global Financial Crisis ('GFC') from 2007 to 2008.[372] The GFC began in 2007 with a crisis in the subprime mortgage market in the United States of America ('USA') and was triggered by the collapse of the investment bank Lehman Brothers on 15 September 2008. Excessive risk taking by banks such as Lehman Brothers exacerbated the financial impact globally and forced governments to bail out financial institutions and introduce monetary and fiscal policies to prevent a possible collapse of the world's financial system.[373]

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[368] *Collins Dictionary* (online at 3 Oct 2022) 'law'.

[369] Deutsch et al (n 360) 2038.

[370] *Commissioners of Inland Revenue v Willoughby* [1997] 4 All ER 65, 73.

[371] *Addressing Base Erosion and Profit Shifting* (n 23).

[372] Peter Eigner, and Thomas Umlauft, 'The Great Depression(s) of 1929–1933 and 2007–2009? Parallels, Differences and Policy Lessons' (MTA-ELTE Crisis History Working Paper No. 2, Hungarian Academy of Science, 1 July 2015).

[373] Mark Williams, *Uncontrolled Risk* (McGraw-Hill Education, 2010).

Notwithstanding this, the GFC crisis was followed by a global economic downturn, which in turn precipitated a crisis in the banking system of European countries using the euro.[374]

The intellectual deftness of international taxation advisers to MNEs, and the complexity of many multinational commercial transactions, have resulted in an escalation of schemes and arrangements by multinationals that produce questionable tax-effective outcomes for these taxpayers. Once these activities have been identified as significant in number and quantum of lost tax revenue, specific anti-avoidance rules are designed and implemented to control the inappropriate behaviour. The use of specific integrity measures rather than general anti-avoidance rules has the advantage of precision.

Specific anti-avoidance measures are therefore basic policy injunctions designed to discourage taxpayers from engaging in tax planning activities by cancelling the tax advantage gained. Anti-avoidance rules are inserted in bilateral tax treaties and in domestic legislation to mitigate the risk of abuse by taxpayers: 'where the only or the primary reason for choosing the structure is tax motivated, it should be considered abusive behaviour and ought to be countered by the legislator. One way to counter such abusive behaviour is by enacting anti-avoidance rules.[375] This will be examined in detail in Chapter 5.

GAARs are designed to negate tax benefits obtained by taxpayers through abusive activities not specifically addressed in tax treaties or domestic legislation. GAARs have operated for many years in most common-law jurisdictions including Hong Kong (Sections 61 and 61A of the *Inland Revenue Ordinance*)[376]; Canada (Section 245 of the *Canadian Income Tax Act*)[377]; New Zealand (Sections BG1 and GB1 of the *New Zealand Income Tax Act 1994*)[378]; South Africa (Sections 80A to 80L of the *Income Tax Act 1962*)[379]; and Australia. Australian governments use a variety of GAARs to combat what are perceived to be abusive avoidance activities. These measures include Part IVA of the *Income Tax Assessment Act 1936*[380], Section 67 of the *Fringe Benefits Tax Assessment Act 1986*[381], and Division 165 of the *A New Tax System (Goods and Services Tax) Act 1999*[382]. This will be examined in more detail in Chapter 5.

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[374] See, eg, Seth Feaster, Nelson Schwartz and Tom Kuntz, 'NYT – It's All Connected-A Spectators Guide to the Euro Crisis', *The New York Times* (online, 22 October 2011), <www.http://nytimes.com>.

[375] Reuven Avi-Yonah and Oz Halabi, 'U.S. Treaty Anti-Avoidance Rules: An Overview and Assessment' (*Law & Economics Working Paper* 45, OECD, 2012), 2 <http://repository.law.umich.edu/law_econ_current/art45>.

[376] *Inland Revenue Ordinance,* Hong Kong, http://www.ird.gov.hk/index.htm.

[377] *Income Tax Act* R.S.C., 1985, c. 1 (5th Supp.)

[378] *New Zealand Income Tax Act 1994*.

[379] *Income Tax Act 1962,* South Africa.

[380] *Income Tax Assessment Act 1936* (Cth).

[381] *Fringe Benefits Tax Assessment Act 1986* (Cth).

[382] *A New Tax System (Goods and Services Tax) Act 1999* (Cth).

4.2 Key Areas of Base Erosion and Profit Shifting

4.2.1 Profit Shifting

Profit shifting is a profit allocation method, involving business restructurings, employed by multinational corporations to attribute before-tax profit or loss to different tax jurisdictions to reduce the overall tax liability of the enterprise. When governments became aware that around 60% of world trade takes place within MNEs, they saw an opportunity to substantially increase their tax revenue from taxing MNEs. Since then, the levels of enforcement have increased incrementally, as has the multiplicity of tax avoidance activities. For example, there has been a long-running battle in the Indian courts between the government and Vodafone over profit-shifting issues.[383]

Corresponding with this increasing interest of governments in scrutinising financial transactions, the uncertainty produced by some domestic transfer-pricing rules has also increased. It is generally considered that a significant cause of this uncertainty is the tax authorities' varying applications of the arm's length standard.[384]

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[383] *Vodafone v Union of India* [S.L.P. (C) No. 26529 of 2010, dated 20 January 2012].

Capital Gains Tax is levied in India pursuant to section 45 of the *Income Tax Act 1961* (the Act) and is assessed and payable on the 'transfer of a capital asset situated in India'. 'Capital Assets' is defined in the Act as 'property of any kind held by an assessee, whether or not connected with his business or profession'.

Pursuant to Section 9 (1)(i) of the Act, which was the central issue of the controversy, income accruing indirectly or directly from the transfer of a capital asset situated in India is deemed to accrue in India. The petitioner Vodafone (based in the Netherlands) acquired Cayman Islands based Company CGP Holdings Limited from Hutchinson Telecommunications International Limited. The deal was concluded at 11.1 billion dollars and resulted in CGP Holdings controlling 52 % of Hutchinson-Essar Limited (based in India) and with the option to buy an additional 15 %. Consequently, Vodafone had effective control of 67% of Hutchison-Essar. The Indian income tax authorities claimed Vodafone was to pay tax on capital gains accrued due to the consequent control of Hutchinson-Essar Limited. The amount of tax payable was estimated at US$2.5 billion. The Supreme Court expressed the view that the transfer of shares of CGP did not result in a transfer of capital assets.

The Indian tax authorities filed a case against Vodafone in the Bombay High Court. The court held that a prima facie case was made out by the tax authorities of transfer of capital assets, and therefore Vodafone was liable to pay the capital gains tax. As Hutchison- Essar was a company situated in India, the Indian tax authorities contended that the purpose of the acquisition of CGP was to acquire effective control in Hutchison- Essar. Vodafone contended that the Tax Authorities had no territorial jurisdiction over the transaction as the acquiring company as well as the company acquired were not based in India.

Vodafone in its turn filed a Special Leave Petition before the Supreme Court that held the Bombay High Court had erred in its decision and should have employed a "look at" approach instead of a "look through" approach. They relied on the principal of corporate personality wherein the identity of the shareholder is distinct from that of the company. The Court said that the Indian tax authorities must look at the transaction at its "face value" rather than the hidden intent behind it. The acquisition of CGP Holdings was not solely to gain control over Hutchinson-Essar, but the gain in control was a corollary of the acquisition, which was not the purpose of the acquisition.

[384] Robert Plunkett and Bill Yohana, 'BEPS and Financial Transactions' (19 September 2014) *International Tax Review* para 1.

Article 9 of the OECD *Model Tax Convention on Income and on Capital*:

1.6 The authoritative statement of the arm's length principle is found in paragraph 1 of Article 9 of

the OECD Model Tax Convention, which forms the basis of bilateral tax treaties involving OECD member

Deloitte’s Robert Plunkett and Bill Yohana revealed in an article published in the *International Tax Review* on 19 September 2014 that tax authority audits of financial transactions have increased significantly.[385] They attributed this to several factors, the most notable of which is that the value of intragroup financial transactions has increased notably, thereby alerting governments to the potential revenue benefits from increasing focus on this area. Some governments, including that of Australia,[386] ‘attribute the increase to potential tax planning opportunities, thereby increasing the potential revenue benefit from focusing on this area from a tax administration perspective’.[387] Plunkett and Yohana point out that in the past this area of intragroup financial transactions was not properly documented by many taxpayers and is now one of the areas most likely to be reviewed by taxation authorities.[388]

According to Professors Brauner and Baez Moreno of the University of Florida Law School, the two key issues addressed by the BEPS Project are:

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countries and an increasing number of non-member countries. Article 9 provides:

[Where] conditions are made or imposed between the two [associated] 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.

[385] Ibid paragraph 2.

[386] See, eg, Treasury (Cth) (n 30).

5.3 Trends in Sources of Risk

‘The global reach of multinational enterprises is also evident in strategies that seek to exploit gaps and inconsistencies in tax treaties between countries. Such schemes have seen the rise of “stateless income”, which is argued to pose an increasing challenge to the tax sovereignty of national governments, or situations where tax treaties delegate residency to the domestic rules of the countries, enabling multinational enterprises to create “stateless entities”.

Our treaties are an important feature of our international tax architecture and provide significant benefits to Australia, however, the risks associated with the treaty network are growing and we need to be aware of the factors driving those risks. Some tax planning structures utilise the sequencing of transactions through jurisdictions to take advantage of treaty provisions or avoid treaty limitations. Tax planning, like many other innovative products or services, is able to be diffused and replicated readily.

The size of the treaty network is also a risk. The global treaty network, rather than simply the Australian network, present opportunities for structures that can shift profits out of Australia. The size of the treaty network presents challenges around ensuring our own treaties continue to serve the national interest but also in relation to limitations on our ability to influence the bilateral treaties of other countries. Finally, the rapid adoption of technology by businesses does not sit well with the slow pace at which countries, and the international community more broadly, change their treaty practice.

A key concern is that tax planning techniques developed as a result of these strategies are becoming more prevalent over time. That is, there is a product life cycle of tax planning techniques, whereby the longer they are able to be used without being challenged the more they will be seen as acceptable and used more broadly through the community. Moreover, 'in competitive markets whatever is possible becomes necessary'. This could help to explain the OECD's conclusion that 'a number of indicators show that the tax practices of some multinational companies have become more aggressive over time'.

[387] Plunkett and Yohana (n 384).

[388] Ibid.

- under-taxation of so-called stateless income also called double non-taxation; and
- an unacceptable division of tax revenues (collected from the digital economy) that leaves source jurisdictions wanting.[389]

Brauner et al point out that source countries claim that the 'volume and importance of the digital economy and the flexibility of its business models increasingly permit operation in a manner that avoids source taxation'.[390] This claim may take two slightly different forms: it can be a claim by a developing, including emerging, economy that such development is unfair because it accelerates the wealth transfer from developing to developed countries. Alternatively, it may be claimed that such a development has so fundamentally altered the global economy that it rendered the current compromise (based on physical presence) inappropriate because it is no longer viewed as a fair and legitimate balance between source and residence taxation.[391]

4.2.2 Hybrid Mismatch Arrangements

Hybrid mismatch arrangements exploit the differences in the tax treatment of instruments, entities, or transfers between two or more countries. Hybrid mismatch arrangements have been encountered by tax administrations in many countries. They often lead to 'double non-taxation' that may not be intended by either country or may alternatively lead to a tax deferral, which has a similar economic outcome to double non-taxation if it is maintained over several years.[392]

These arrangements often employ financial instruments that present features typically connected with debt and equity. For example, fees for derivative contracts, such as forwards or interest rate swaps, may economically replace interest payments and thus avoid withholding tax at source, either because the relevant domestic law does not subject these payments to tax at source or because the relevant double tax treaty may prevent the country from taxing the income at source. Other financial transactions, including those involving captive insurance or derivatives, can give rise to similar outcomes whereby payments are deductible in one country but not taxed in another country. Hybrid mismatch arrangements generally use one or more of the following fundamental features:

- Hybrid entities: Entities that are treated as transparent for tax purposes in one country and as non-transparent in another country.
- Dual residence entities: Entities that are resident in two different countries for tax purposes.

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[389] Yariv Brauner and Andres Baez Moreno, 'Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy' (WU International Taxation Research Paper Series No. 2015-14, WU Vienna Business Taxation Group, 2 February 2015) <http://ssrn.com/abstract=2591830>.

[390] Ibid 2.

[391] Ibid.

[392] OECD, *Hybrids Mismatch Arrangements: Tax Policy and Compliance Issues,* (OECD Publishing, 2012) <https://www.oecd.org/tax/exchange-of-tax-information/hybridmismatcharrangementstaxpolicyandcomplianceissues.htm>.

- Hybrid instruments: Instruments which are treated differently for tax purposes in the countries involved, most prominently as debt in one country and as equity in another country.
- Hybrid transfers: Arrangements that are treated as ownership transfer of an asset for one country's tax purposes but not for tax purposes of another country, which generally sees it as a collateralised loan.[393]

Hybrid mismatch arrangements generally fall within one of the following categories:

- Double deduction schemes: Arrangements where a deduction related to the same contractual obligation is claimed for income tax purposes in two different countries.
- Deduction / no inclusion schemes: Arrangements that create a deduction in one country, typically a deduction for interest expenses, but avoid a corresponding inclusion in the taxable income in another country.
- Foreign tax credit generators: Arrangements that generate foreign tax credits, which arguably would otherwise not be available, at least not to the same extent or not without more corresponding taxable foreign income.[394]

Instruments that are not ordinary shares but are treated wholly or partly as equity or capital by rating agencies and/or regulatory authorities, such as the Australian Prudential Regulation Authority, are known as hybrid instruments. Hybrid instruments issued by Australian resident companies may generally be classified as follows:

- long-term subordinated notes or preference shares issued by unregulated corporations which give the issuer the option to defer the payment of interest or dividends and which are treated, at least in part, as equity by ratings agencies;
- term subordinated notes, which qualify as Tier 2 capital, issued by regulated institutions;
- perpetual subordinated notes or preference shares, which qualify as Tier 1 capital, issued by regulated institutions.[395]

Other examples of hybrid instruments are:

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[393] Ibid 7.

'While there can be several layers of complexity, arrangements exploiting differences in the tax treatment of instruments, entities or transfers between two or more countries are often based on similar underlying elements and aim at achieving similar effects. This describes the most common elements of hybrid mismatch Arrangements'.

[394] Ibid 7.

'For example, assume that a company in Country A buys financial instruments issued by a company in Country B. Under Country A's tax laws, the instrument is treated as equity, whereas for Country B's tax purposes the instrument is regarded as a debt instrument. Payments under the instrument are considered deductible interest expenses for the company under Country B tax law while the corresponding receipts are treated as dividends for Country A tax purposes and therefore exempt'.

[395] Deutsch et al (n 360) 1268.

- Financial contracts for differences that allow investors to take risks on movements in the price of a 'subject matter' without ownership of that subject matter. The ATO Ruling TR 2005/15 determined that gains from such investments will be assessable income under Section 6-5 of the *Income Tax Assessment Act 1997* ('ITAA 1997') where the transaction is entered in the ordinary course of carrying on of a business or where the profit was obtained commercially.[396]
- Commercial bill facilities where an annual financing cost is paid in advance under a fixed-rate commercial bill for a purpose that satisfies deductibility under Section 8.1 ITAA 1997.[397]
- Amounts paid under interest rate swap contracts are not 'interest' for withholding tax purposes and, if those amounts are attributable to existing interest expenses, they are revenue (that is non-capital) in nature.[398]

4.2.3 Tax Avoidance via Electronic Commerce

The OECD *Technical Advisory Group ('TAG') on Monitoring the Application of Existing Treaty Norms for Taxing Business Profits* was set up by the Committee on Fiscal Affairs in January 1999, with the instruction to 'examine how the current treaty rules for the taxation of business profits apply in the context of electronic commerce and examine proposals for alternative rules'.[399] The TAG, at its first meeting in September 1999, approved a work programme that contained the following ten elements:[400]

1. consideration of how the current treaty rules for the taxation of business profits apply in the context of electronic commerce, with emphasis on four issues:
   2. the 'place of effective management'
   3. the concept of a Permanent Establishment (PE)
   4. the attribution of profit to a server PE and

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[396] Australian Taxation Office, *Income Tax: Tax Consequences of Financial Contracts for Differences* (TR 2005/15) <http://law.ato.gov.au/atolaw/view.htm?docid=TXR/TR200515/NAT/ATO/00001>.

[397] Australian Taxation Office, *Income Tax Deductibility: 'Annual Financing Costs' Paid in Advance under a Fixed Interest Commercial Bill Facility - date incurred* (ID 2003/8490) 2003.

Are 'annual financing costs', paid in advance under a Fixed Rate Commercial Bill Facility, incurred on the date that the facility is drawn down and on the subsequent anniversary date of the drawdown, given that the purpose for which the facility is drawn satisfies the conditions for deductibility under the *Income Tax Assessment Act 1997* (ITAA 1997)? Decision. Yes. The 'annual financing costs', paid in advance under a Fixed Rate Commercial Bill Facility, are incurred on the date that the facility is drawn down and on the subsequent anniversary date of the drawdown.

[398] Australian Taxation Office, *Interest-swapping Transactions* (Ruling IT 2050, as amended 20 July 1983).

Ruling: 'An "interest swapping" arrangement is a form of interest hedging facility and is a transaction quite independent of any loan obligations of the parties to which the arrangement might be referable. It does not involve any additional loans between the parties or any disturbance of existing loans and obligations to pay interest as it falls due'.

[399] OECD, 'Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?' (Final Report, Centre for Tax Policy and Administration, 2001) <http://www.oecd.org/tax/treaties/35869032.pdf>.

[400] Ibid.

5. transfer pricing
6. consideration of the pros and cons of applying the existing treaty rules considering anticipated developments in electronic commerce
7. the development of criteria to facilitate the evaluation of existing treaty rules in the context of electronic commerce
8. an assessment of whether, and if so how, the current treaty rules should be clarified in the light of electronic commerce
9. the identification of alternatives to the current treaty rules for determining the taxing rights of source and residence countries and for the allocation of profit between the taxing jurisdictions
10. an assessment of the alternatives to the current rules on the basis of the evaluation criteria.

Whilst there are significant differences between bilateral tax treaties, the principles underlying the treaty provisions governing the taxation of business profits are relatively uniform and may be summarised as follows:[401]

1. liability to a country's tax: residents and non-residents;
2. permanent establishment: the treaty nexus/threshold for taxing business profits of non-residents;
3. computation of profits: the separate entity accounting and arm's length principles;
4. treaty rules for sharing the tax base between States where there is nexus.[402]

The TAG considered the current treaty definition of PE in the context of e-commerce and came to the following conclusions:

1. A website cannot by itself constitute a PE.
2. Web site hosting arrangements typically do not result in a PE for the enterprise that carries on business through the hosted website.
3. Except in very unusual circumstances, an Internet service provider will not be deemed (under the agent/permanent establishment rule described above) to constitute a PE for the enterprises to which it provides services.
4. A place where computer equipment, such as a server, is located may in certain circumstances constitute a PE, this requires that the functions are carried out with or without the presence of personnel.[403]

The TAG reported that at the date of the examination there was no apparent evidence of a significant reduction of a country's direct tax revenues that could be attributed to e-commerce. The TAG agreed that it

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[401] Ibid 6.

[402] Ibid.

[403] Ibid 7.

would not be advisable to suggest any tax policy change based on perceived tax revenue losses that have not been established, but it also agreed that the evolving impact of e-commerce on tax revenues needed to be monitored.[404]

Tax policy is at the core of all countries' sovereignty, and each country has the right to design its tax system in the way it considers most appropriate. At the same time, the increasing interaction of domestic economies has exacerbated the gaps that can be created by discrepancies in domestic tax laws. Therefore, the OECD sees a need to complement the existing rules contained in over 3,500 tax treaties and domestic laws with a new set of standards, optimistically designed to introduce a degree of international coherence to corporate income taxation. Action 1 of the OECD/G20 Action Plan has set a similar task to that undertaken by the TAG in 1999.

Professor Dale Pinto of Curtin University examined the tax issues raised by electronic commerce in 1999, and endorsed the approach adopted at that time by the Australian Taxation Office, which he summarised as:

1. apply existing treaty principles
2. review and clarify their application
3. consider alternatives to current rules, to be prepared if the existing principles prove to be inadequate.[405]

Pinto expressed the view then, and more recently, that e-commerce (digital economy) 'is not really "new" and can be thought of as representing a natural evolution of the traditional models of business-to-business and business-to-consumer commerce'.[406] In a 2014 paper, he examined electronic commerce from the perspective of the OCED/G20 BEPS Action Plan, including options available to countries in addressing the challenges to corporate tax revenue raised by the ongoing expansion of the digital economy.[407] This paper was written in response to Action 1 of the OECD Action Plan on Base Erosion and Profit Shifting and again advanced the opinion that 'in many ways the digital economy does not really represent anything new'.[408]

4.2.4 Related Party Debt-Financing, Captive Insurance, and Other Intra-group Financial Transactions

Money is mobile and interchangeable, which enables multinational groups to achieve favourable tax outcomes by adjusting the amount of debt in a group entity.[409] This allows such groups to increase the debt

[404] Ibid.

[405] Dale Pinto, 'Taxation Issues in a World of Electronic Commerce (1999) 2(4) *Journal of Australian Taxation* 227.

[406] Ibid, paragraph 3.10.2. See also, Pinto, 'A Preliminary Analysis' (n 75).

[401] Pinto, 'A Preliminary Analysis' (n 75).

[408] Ibid 7–9.

[409] Ibid.

levels of individual group entities through intra-group financing. Financial instruments can also be used to make payments which are economically 'equivalent to interest but have a different legal form, therefore escaping restrictions on the deductibility of interest'.[410] Risks of BEPS by multinationals arise in the following three sets of circumstances:

1. groups placing higher levels of third-party debt in high-tax jurisdictions
2. groups using intragroup loans to generate interest deductions exceeding the group's actual third-party interest expense
3. groups using third party or intragroup financing to fund tax-exempt income.[411]

The 2013 OECD Report *Addressing Base Erosion and Profit Shifting*[412] called for recommendations 'regarding best practices in the design of rules to prevent base erosion by using interest expenses'.[413] The immediate response by the Australian Government to BEPS was to introduce the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013,* which came into force on 29 June 2013.[414]

4.2.5 Avoidance of Permanent Establishment Status

In Action 7 of the BEPS Project, the OECD addressed common tax avoidance strategies used to prevent the existence of a Permanent Establishment, including through agency or commissionaire arrangements instead of establishing related distributors. Action 7 also aims to prevent the misuse of specific exceptions to the PE definition, which relate to activities of a preparatory and auxiliary character. The changes in the PE definition have significant consequences for international groups. Some sectors, especially the retail and consumer industry, seem to be even more exposed than others to the changes. Effecting the changes to the PE definition will require amendments to bilateral tax treaties. To facilitate this process, the OECD has developed a multilateral instrument that will implement the results of tax treaty-related BEPS measures in existing bilateral tax treaties.[415]

Rules have also been introduced to prevent the breakup of an operating business into several small business units in order to benefit from the preparatory or auxiliary exemption. As a result of the new provisions, the

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[410] OECD, 'Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4-Final Report' (OECD/G20 Base Erosion and Profit Shifting Project, 2015) 11.

[411] Ibid.

[412] *Addressing Base Erosion and Profit Shifting* (n 23).

[413] Ibid. 'The recommended approach is based on a fixed ratio which limits an entity's net deductions for interest and payments economically equivalent to interest to a percentage of its earnings before interest, taxes, depreciation and amortisation'.

[414] *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth).

[415] Susann van der Ham and Robert Halat, 'Implications of the new permanent establishment definition on retail and consumer multinationals' (Transfer Pricing Perspectives, PwC, October 2016) < https://www.pwc.com/gx/en/tax/publications/transfer-pricing/perspectives/assets/tp-16-implications.pdf>.

activities performed by different related parties are to be combined (analysed on an aggregated basis) when assessing whether they can be regarded as of a preparatory or auxiliary nature.[416]

According to the existing provisions, a PE arises when work on a construction site lasts at least 12 months. In order to prevent artificially splitting up contracts into shorter periods, the OECD advocates for a principal purpose test or a specific provision that allows combining the activities of the related enterprises carried out at one construction site during different periods, each exceeding 30 days, when determining the duration of work.[417]

The most significant impact on retail and consumer multinationals will likely result from the changes to specific activity exemptions. According to the OECD, the decisive factor in assessing whether a given activity can be regarded as preparatory or auxiliary involves determining whether the activity carried out by the place of business in itself forms an essential and significant part of the overall activity of the enterprise. In particular, the activity cannot be regarded as of a preparatory or auxiliary nature when the general purpose of the activity performed by the place of business is the same as the general purpose of the whole enterprise. For companies operating in the retail and consumer industry, activities such as purchasing or warehousing typically correspond to a company’s core business activities, and thus these companies may no longer benefit from the existing activity exemptions.[418]

Further considerations on the potential influence of the new PE regulations on purchasing and warehousing functions are presented below. Purchasing retail and consumer multinationals often use central buying entities to streamline purchases. These entities are typically represented in local markets by related party service providers or purchasing offices. In principle, the responsibilities of such local units include searching, auditing, and selecting suppliers, as well as negotiating with suppliers with regard to products and the commercial terms of cooperation. Under the new PE definition, such local places of business will constitute a PE as the purchasing function is an essential and significant part of the enterprise’s overall activity (consisting of selling these goods).[419]

The other model used by multinationals involves a central purchasing department that provides support services for the operating companies that purchase goods directly from suppliers. Such support usually includes selecting and recommending suppliers, negotiating global purchase agreements with suppliers, and supporting negotiations with local suppliers.[420]

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[416] Ibid.

[417] Ibid.

[418] Ibid.

[419] Ibid.

[420] Ibid.

4.2.6 Thin Capitalisation

'Thin capitalisation' is a tax term used to describe circumstances in which a taxpayer has cross-border investments and the taxpayer's allowable interest deductions are limited by a specified statutory ratio or formula. The limit is imposed to counter the strategy of using debt over equity funding to obtain the more favourable tax treatment of debt.[421] The method of tax avoidance employed may involve the use of a thinly capitalised subsidiary that borrows from the parent or an offshore vehicle located in a lower tax jurisdiction.

Professors Valeria Merlo and Georg Wamser of the University of Hohenheim argue that the differences in tax rates between countries invite multinationals to 'thinly capitalize foreign affiliates in high-tax countries and rely instead to an excessive extent on debt financing'.[422] They suggest that multinationals minimise their overall tax burden, particularly by using 'internal (related-party) debt as a vehicle for shifting profits by injecting equity financing into a foreign affiliate facing a low tax rate'.[423] This affiliate may then provide loans to related entities within the MNE in high-tax countries. Consequently, the high-tax countries incur a reduction of the tax base due to the deduction of the interest expenses.[424]

Merlo and Wamser conclude that an increasing number of countries are including thin capitalisation rules in their tax legislation, 'with the aim of reducing profit shifting by MNEs'.[425] They suggest that since the shifting of profits allows multinationals to avoid high taxes on corporate profits, national policymakers should consider that uncoordinated measures against debt shifting are generally less effective than a coordinated approach. Moreover, they endorse the report by the OECD that notes, 'government actions should be comprehensive and deal with all the different aspects of the issue'.[426] Those actions should not only include measures against all channels of profit shifting (e.g., transfer pricing) but also attempts to increase cooperation with tax haven countries.[427]

4.2.7 Harmful Preferential Regimes

Action 5 of the OECD/G20 BEPS Action Plan is concerned with countering 'harmful tax practices more effectively, considering transparency and substance'.[428] The Final Report on Action 5 presents an

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[421] Deutsch et al (n 360) 1399.

[422] Valeria Merlo and Georg Wamser, 'Debt Shifting and Thin-capitalization Rules' (4 December 2014) 12(4) *CESifo DICE Report* 27–31.

[423] Ibid.

[424] Ibid.

[425] Ibid 30.

[426] OECD report cited in Merlo and Wamser (n 422)

[427] Merlo and Wamser (n 422) 30.

[428] *Action Plan on Base Erosion and Profit Shifting* (n 25). 'Preferential regimes continue to be a key pressure area. Current concerns are primarily about preferential regimes which can be used for artificial profit shifting and about a lack of transparency in connection with certain rulings'.

appropriate methodology for assessing whether there is 'substantial activity'. The report proposes the 'nexus approach', which uses expenditures as a substitute for substantial activity. This approach is directed at ensuring taxpayers only benefit from intellectual property regimes where they incurred actual expenditure on research and development. The report discloses that to address transparency, a framework has been established to exchange information compulsorily on rulings that could give rise to BEPS concerns.[429]

The Final Report covers two main areas:

- the definition of a 'substantial activity' criterion to be applied when determining whether tax regimes are harmful; and
- improving transparency.

Multinational accounting firm Ernst & Young examined the material covered by BEPS Action 5 in *Global Tax Alert*, 8 October 2015.[430] They reported that Action 5 touched on a wide variety of topics, including 'requirements for intellectual property (IP) and other regimes, the determination of which IP regimes are allowable and which need to be phased out, what constitutes a harmful preferential regime, which ruling information is to be mandatorily exchanged and to whom, what qualifies as a "ruling" and best practices for cross-border rulings (the process for granting rulings, terms, publication)'.[431]

Once a regime has been identified as 'preferential', four key factors and eight other factors are used to determine whether the preferential regime is potentially harmful. The four key factors are:

- The regime imposes no or low effective tax rates on income from geographically mobile financial and other service activities.
- The regime is ring-fenced from the domestic economy.
- The regime lacks transparency (e.g., the details of the regime or its application are not apparent, or there is inadequate regulatory supervision or financial disclosure).
- There is no effective exchange of information with respect to the regime.[432]

The first factor (no or low effective tax) is a gateway criterion: if this criterion is not met, the regime will not be considered harmful. If the criterion is met, the other three key factors and, where relevant, the eight other factors need to be evaluated. It only takes one of the remaining three key factors to be met to have a regime characterised as potentially harmful.

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[429] Ibid.

[430] Ernst & Young, 'OECD releases final report on countering harmful tax practices under Action 5' (8 October 2015) *Global Tax Alert* <http://www.ey.com/gl/en/services/tax/international-tax/alert--oecd-releases-final-report-on-countering-harmful-tax-practices-under-action-5>.

[431] Ibid.

[432] Ibid para 15.

The eight other factors generally help to spell out, in more detail, some of the principles and assumptions that should be considered in applying the key factors themselves. They are:

1. artificial definition of the tax base
2. failure to adhere to international transfer pricing principles
3. foreign source income exempt from residence country taxation
4. negotiable tax rate or tax base
5. existence of secrecy provisions
6. access to a wide network of tax treaties
7. promotion of the regime as a tax minimisation vehicle and
8. encouragement of operations or arrangements that are purely tax-driven and involve no substantial activities.[433]

The final step is to apply the tests above and decide whether a 'potentially' harmful regime is 'actually harmful' by analysing whether it has harmful economic effects. This analysis should reveal whether the regime facilitates a shift of activities from one country to the country providing the regime rather than generating new activities. Considerations of whether the activities in the host country correspond to the amount of investment or income, and whether the preferential regime is the primary motivation for the location of an activity, are also relevant.[434]

Primarily, the *Harmful Tax Practices Report* used the 'nexus approach' as the agreed approach to defining the 'substantial activity' requirement for the intellectual property (IP) regime.[435] This approach links the application of an IP regime (patents and copyrighted software) to the taxpayer's level of research and development (R&D) activities. Sixteen existing IP regimes were reviewed and found to have failed the nexus test. When applying the nexus approach to activities other than IP, there also would need to be a link between the income qualifying for benefits and the core activities necessary to earn the income. The Final Report describes the activities that could be employed to link with headquarter regimes, distribution and service centres, financing or leasing, fund management, banking and insurance, and shipping.

The second priority of Action 5 is to improve transparency through a 'compulsory spontaneous exchange of information on certain rulings'. This framework will apply to taxpayer-specific rulings that are:

1. rulings on preferential regimes

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[433] Ibid para 17.

[434] Ibid para 18

[435] Deloitte, United Kingdom, 'BEPS Action 5: Harmful Tax Practices' <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-uk-beps-action-5.pdf#:~:text=The%20OECD's%20work%20on%20harmful%20tax%20practices%20was,revamp%20its%20previous%20work%20on%20harmful%20tax%20practices>.

2. unilateral advance pricing agreements (APAs) or other cross-border unilateral rulings in respect of transfer pricing
3. cross-border rulings providing for a downward adjustment of taxable profits (particularly excess profit and informal capital rulings)
4. permanent establishment rulings
5. related party conduit rulings.[436]

4.3 Conclusion

This chapter briefly examined sham transactions, tax fraud, tax evasion and tax avoidance so the distinction between each of these groupings is clear. The distinction between tax avoidance and tax evasion can be very fine and depend on an exhaustive examination of all available evidence. This chapter then examined the following key areas of tax avoidance from among the larger group.

[1] Profit shifting

'Profit shifting' is the name given by the OECD to a practice exercised by MNEs that diverts profits away from tax jurisdictions with high tax rates to those with lower tax rates. In general terms, this involves protecting the tax base of developed jurisdictions at the expense of developing countries.

[2] Hybrid mismatch arrangements

Hybrid mismatch arrangements are arrangements between taxpayers that exploit discrepancies between the tax laws of two or more countries to avoid tax.

[3] Tax avoidance via electronic commerce

While the aim of Pillar 1 and Pillar 2 is primarily to enforce a minimum tax of 15% for large multinational corporations, it will also have the effect of depriving developing tax jurisdictions of the opportunity of attracting mobile capital and taxation opportunities by diminishing the low tax incentives offered by some developing countries. Electronic commerce occurs between taxpayers, without tax departments being aware that a transaction has occurred. The ATO is addressing this area aggressively and, to date, it is of minor significance in Australia.

Whilst these and other strategies are employed to minimise international tax avoidance, this endeavour will never be reduced while the current bilateral regime remains in force. The commercial world is evolving rapidly, and a rapid response mechanism to keep up with these developments is necessary to counter new threats to government revenue including:

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[436] OECD, 'BEPS Action 5 on Harmful Tax Practices – Terms of Reference and Methodology for the Conduct of the Peer Reviews of the Action 5 Transparency Framework (OECD/G20 Base Erosion and Profit Shifting Project, 2017) <www.oecd.org/tax/beps/beps-action-5-harmful-tax-practices-peerreview-transparency-framework.pdf>.

- Increasing well-being expectations from populations
- Climate change costs
- Developing importance of defence spending.

Chapter 5 investigates key BEPS anti-avoidance measures.

CHAPTER 5: KEY BEPS ANTI-AVOIDANCE MEASURES

5.1 Introduction

This chapter investigates the BEPS anti-avoidance measures recommended by the OECD and adopted by the Australian Government to counter the BEPS strategies referred to in the previous chapter. Multinationals, through the instrumentality of their tax advisors, continually develop new variants of the multiple schemes that comprise BEPS, to ensure their clients maintain an advantage over tax authorities, often constrained by fiscal circumstances. Several scholars and policymakers have explored the possibilities of an international tax organisation that could propose and/or implement international tax policy,[437] the harmonisation of withholding tax rates,[438] and a basic world tax code.[439]

Government attempts to mitigate the erosion of their tax bases attributable to BEPS, either unilaterally, through domestic anti-avoidance legislation, by exchange of information agreements, or by a variety of mutual co-operations via bilateral tax treaties. For example, the OECD *Addressing Base Erosion and Profit* report, published on 12 February 2013, called for recommendations 'regarding best practices in the design of rules to prevent base erosion by using interest expenses'.[440] The unilateral response by the Australian Government to the BEPS report was to formulate and introduce the *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013,* which came into force on 29 June 2013.[441]

Prior to the OECD BEPS initiatives, Australia already had strong anti-avoidance rules within the existing tax framework. Australia has led the way by expeditiously introducing new laws to incorporate the recommendations from the OECD contained in the OECD/G20 BEPS Action Plan. Accordingly, the Australian anti-avoidance rules will be examined as representative of global tax jurisdictions.

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[437] See for example, Reuven Avi-Yonah, 'Commentary: Treating Tax Issues Through Trade Regimes' (2000-2001) 26(4) *Brooklyn Journal of International Law* 1683; Arthur Cockfield, 'The Rise of the OECD as Informal "World Tax Organization" through National Responses to E-Commerce Tax Challenges' (2006) 8(59) *Yale J. L. & Tech.* 136; Frances Horner, 'Do We Need an International Tax Organization?' (2001) 24(2) *Tax Notes Int'l* 179; C. McLure, 'Globalization, Tax Rules and National Sovereignty (2001) 55(8) *Bulletin for International Fiscal Documentation* 328–341; Dale Pinto, 'A Proposal to Create a World Tax Organisation' (2003) 9 *New Zealand Journal of Taxation Law and Policy* 145–160; D. Spencer, 'The UN a forum for global tax issues? (Part 2)' (2006) 17(3) *Journal of International Taxation* 30-44; Vito Tanzi, 'Is there a Need for World Tax Organisation?' in Razin/Sadka (eds), *The Economics of Globalization* (Cambridge University Press, 1999) 173; see also the proposal in United Nations, 'Report of the High-Level Panel on Financing for Development' <http://www.un.org/reports/financing/full_report.pdf>.

[438] See for example, Richard Bird, 'The Interjurisdictional Allocation of Income and the Unitary Taxation Debate' (1986) 3 *Australian Tax Forum* 333; P Musgrave, 'Tax Base Shares: Unitary versus Separate Entity Approaches' (1979) 21 *Canadian Tax Foundation* 445.

[439] See, eg, Ward Hussey and Donald Lubick, *Basic World Tax Code and Commentary* (1996) <http://www.taxhistory.org/www/bwtc.nsf/PDFs/basica.pdf/$file/basica.pdf>; Brian Arnold, 'International Aspects of the Basic World Tax Code and Commentary' (1993) 7 *Tax Notes Int'l* 260; Richard Krever, 'Drafting Tax Legislation: Some Lessons from the Basic World Tax Code' (1996) 12 *Tax Notes Int'l* 915.

[440] *Addressing Base Erosion and Profit Shifting* (n 23).

[441] *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013* (Cth).

5.2 BEPS Anti-Avoidance Measures

There are several categories of anti-avoidance rules and various avenues by which they can be introduced. These rules may be divided into two main groups:

- General Anti-Avoidance Rules (GAARs); and
- Specific Anti-Avoidance Rules (SAARs).[442]

Anti-avoidance rules can be enacted and implemented by domestic legislation, bilateral and multilateral agreements, court decisions (for example, the European Court of Justice in the European Union), or by the enforcement, interpretation, and policy of domestic authorities.[443] While SAARs are designed to counter a specific area of abusive behaviour, GAARs are used to support SAARs and cover transactions that are not caught by SAARs. By this defence, in-depth, abusive behaviour by taxpayers that avoids the application of a SAAR either due to technicalities or through sophisticated planning might have deductions disallowed or income re-characterised by the operation of a GAAR.[444]

Many countries have introduced SAARs into their domestic tax legislation. Examples of SAARs include controlled foreign company rules and thin capitalisation rules, which are aimed at specific types of behaviour that governments consider to be tax avoidance. These rules are aimed at negating the tax benefits obtained by taxpayers who engage in such behaviour. Multinationals have ready access to highly skilled tax advisors who devise lawful, but questionable, means of minimising their clients' tax liabilities. It is virtually impossible for tax treaties and/or domestic tax laws to contain specific anti-BEPS provisions that deal with every possible tax avoidance structure.[445] Countries including China,[446] the United Kingdom,[447] and

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[442] Avi-Yonah and Halabi (n 375).

[443] Ibid.

[444] Joshua Rosenberg, 'Tax Avoidance and Income Measurement' (1988) 87 *Michigan Law Review* 365.

[445] Anthony Ting, 'Improving the general anti-avoidance regime ("Part IVA") in response to base erosion and profit shifting ("BEPS"): Additional information provided on notice Senate Economic Reference Committee Hearing on Corporate Tax Avoidance'(2016) <http://sydney.edu.au/business/__data/assets/pdf_file/0015/230316/general_anti-avoidance_regime.pdf>.

[446] On 12 December 2014, China's State Administration of Taxation (SAT) released the Administrative Measures on the General Anti-Avoidance Rule (GAAR) in the form of SAT Order No.32. The measures contain comprehensive guidance for implementing GAAR, elaborating on certain principles, adjustment methods, procedures throughout the GAAR life cycle, and relevant documentation requirements. The measures will be effective February 1, 2015. However, the GAAR will not apply to cases that have already been assessed and closed by the effective date. Source: PwC, 'New China GAAR Challenges Structures Implemented Mainly for Tax Benefit'(online, December 2014) *PwC Newsletters* <http://www.pwc.com/gx/en/services/tax/newsletters/tax-controversy-dispute-resolution/new-china-gaar.html>.

[447] The United Kingdom's general anti-abuse rule is Part 5 of the *Finance Act 2013* and applies to the following taxes:

1. income tax.
2. corporation tax, including any amount chargeable as if it were corporation tax or treated as if it were corporation tax.
3. capital gains tax.

Australia[448] have introduced GAARs that apply where a taxpayer obtains a tax benefit that they are not entitled to according to the tax authority but which is not addressed by operation of a SAAR.

A Working Paper published by the OECD Economics Department on 19 December 2016 presents a new classification of anti-avoidance activities, which will be examined in some detail:

1. transfer price rules and documentation requirements
2. rules on interest deductibility, such as thin capitalisation and interest-to-earnings rules, to prevent the manipulation of debt location
3. (CFC rules
4. GAARs
5. bilateral tax treaties and withholding taxes on interest payments, royalties, and dividends.[449]

5.3 OECD Action Plan

On 5 October 2015, the OECD/G20 published 13 Final Reports together with an Explanatory Statement. Australia, as a member of both the OECD and G20, has strongly supported the OECD/G20 BEPS Project.[450] The OECD declared that the current tax rules revealed weaknesses creating opportunities for BEPS and that a substantial renovation of the international tax standards was necessary.[451] The OECD's preference was for these Actions to be implemented in a coordinated fashion.[452] To date, Australia has taken the following BEPS-consistent actions:

1. introduction of stronger transfer pricing legislation in the form of the *Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No. 1) 2012*[453] and *Tax Laws Amendment (Countering Tax Avoidance and Multinational Profit Shifting) Act 2013*

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4. petroleum revenue tax.
5. inheritance tax.
6. stamp duty land tax; and
7. annual tax on enveloped dwellings.

[448] *Income Tax Assessment Act 1936* (Cth), Part IVA.

[449] OECD, 'Anti-avoidance rules against international tax planning: a classification Economics Departments' (OECD Working Papers No. 1356, 19 December 2016).

[450] Scott Morrison (Treasurer), 'Tougher Measures to Tackle Tax Evasion Pass Parliament' (Media Release, 29 February 2016); Joseph Hockey (Treasurer), 'Global Leaders Tackle Profit Shifting and Tax Evasion' (Media Release, 20 September 2014); David, Bradbury, (Assistant Treasurer), 'Supporting Better Tax Policy for a Stronger, Smarter and Fairer Society – Address at the Launch of the Tax and Transfer Policy Institute, Canberra' (Media Release, 27 June 2013).

[451] 'Explanatory Statement' (n 7).

[452] Ibid.

[453] *Tax Laws Amendment (Cross-Border Transfer Pricing) Act (No. 1) 2012* (Cth).

2. introduction of anti-avoidance laws in the *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* to ensure multinationals that make sales in Australia do not avoid tax by booking revenue offshore[454]
3. implementation of OECD recommendations on country-by-country reporting, tax treaty abuse, harmful tax practices, and exchange of rulings through the *Tax Laws Amendment (Implementation of the Common Reporting Standard) Act 2016*[455]
4. conducting an annual tax forum including an update on the BEPS Action Plan[456]
5. exchange of information with other countries on activities of multinational corporations[457]
6. new tax requirements on foreign investment applications to ensure multinational companies investing in Australia pay tax here on what they earn here;[458] and
7. introduction of legislation to remove the competitive tax advantage for overseas companies by applying the GST to digital products and other services sold overseas.[459]

On 7 June 2017, Australia signed the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting,* together with 67 other countries. The Convention is a key measure of the OECD/G20 Base Erosion and Profit Shifting (BEPS) project, which is the latest attempt by the OECD to reduce BEPS. The Convention complements Australia's Multinational Anti-Avoidance Law,[460] the Diverted Profits Tax,[461] and the Tax Avoidance Taskforce[462] and reinforces the ongoing efforts by the

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[454] *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* (Cth).

[455] Ibid.

[456] Mark Konza, (ATO Deputy Commissioner, International), 'Address to the Tax Institute NSW 7th Annual Tax Forum: BEPS Action Plan Update' (Transcript, 22 May 2014). See also Australian Government, 'Budget Measures' (Budget Paper No 2: 2015–16) 15–16.

[457] Scott Morrison (Treasurer) and Kelly O'Dwyer (Assistant Treasurer), 'Coalition bolsters ATO in fight against multinational tax avoidance, (Media Release, 28 January 2016).

[458] Peter Ryan, 'Treasurer will gain power to force foreign companies to sell Australian assets if they avoid paying tax', *ABC News* (online, 22 February 2016) <http://www.abc.net.au/news/2016-02-22/foreign-companies-could-be-forced-to-sell-australian-assets/7188314>.

'The Government is committed to ensuring companies operating in Australia pay tax on their Australian earnings. Where companies fail to do so I will have powers to take action, including ordering divestment of Australian assets. Foreign investment applications will have to comply with Australian taxation law, Australian Taxation Office (ATO) directions to provide information in relation to the investment and advise the ATO if investors enter into any transactions with non-residents to which transfer pricing or anti-avoidance measures of Australian tax law may potentially apply.'

[459] *Tax Laws Amendment (Implementation of the Common Reporting Standard) Act 2016* (Cth).

[460] *Tax Laws Amendment (Combating Multinational Tax Avoidance) Act 2015* (Cth).

[461] *Diverted Profits Tax Act 2017* (Cth).

[462] 'Tax Avoidance Taskforce', *Australian Taxation Office* (Web Page) <https://www.ato.gov.au/general/Tax-avoidance-taskforce/>.

Australian Government to tax large multinationals. The government intends to use the Convention to modify Australia's bilateral tax treaties to improve anti-avoidance rules and improve tax treaty-based dispute resolution mechanisms.[463]

Australia signed the MLI on 7 June 2017. The MLI was given the force of law in Australia by the *Treasury Laws Amendment (OECD Multilateral Instrument) Act 2018*, which received Royal Assent on 24 August 2018, and Australia deposited its instrument of ratification with the OECD Depositary on 26 September 2018. The MLI entered into force in Australia on 1 January 2019. The extent to which the MLI will modify the operation of Australia's tax treaties will depend on the adoption positions taken by each jurisdiction at ratification, acceptance, or approval of the MLI.[464]

Jurisdictions that sign the MLI are required to identify which of their tax treaties they want the MLI to apply to and modify. The tax treaties which are covered by the MLI are called CTAs. Both treaty partners need to identify their tax treaty as a CTA for that treaty's operation to be modified by the MLI. If only one jurisdiction (or neither jurisdiction) identifies a tax treaty as a CTA, the provisions of that treaty will remain un-modified.[465]

The MLI incorporates flexibility allowing jurisdictions to tailor their adoption to fit their particular national circumstances and accommodate unique aspects of their treaty network. Each jurisdiction is required to notify the OECD Secretariat of its set of provisional choices (referred to as that jurisdiction's 'MLI position') at the time of signature (of the MLI) and confirm them at the time of ratification. Jurisdictions' MLI positions are available on the OECD website.[466] While some MLI articles are mandatory (minimum standards), most are optional. Jurisdictions can choose to adopt the minimum standards only or they can choose to adopt some, or all, of the optional articles. If there is a bilateral match, the MLI will modify, but not directly amend, nominated tax treaty clauses. Other unrelated parts of the treaties will remain unchanged.[467]

According to the ATO the ATO Tax Avoidance Taskforce, established in 2016, scrutinises the tax affairs of multinational enterprises, large public and private groups and wealthy individuals operating in Australia. Its role is to ensure these entities pay the right amount of tax and boost Australian community confidence in the tax system.

The taskforce works with their partner agencies to investigate the most aggressive tax avoidance arrangements, including profit shifting.

[463] Senator Mathias Cormann, 'Australia signs new multilateral convention to prevent tax avoidance' (Media Release, 8 June 2017) <http://www.financeminister.gov.au/media-release/2017/06/08/australia-signs-new-multilateral-convention-prevent-tax-avoidance>.

[464] 'Multilateral Instrument' (n 43).

[465] Ibid.

[466] Ibid.

[467] Ibid.

Based on other jurisdictions' known adoption positions, the MLI is expected to modify to varying degrees the operation of many Australian tax treaties. The number of treaties modified by the MLI could change if more of Australia's tax treaty partners sign and ratify the MLI and nominate their treaty with Australia. For the sake of clarification, each treaty will require an examination to determine the extent to which the MLI will modify each treaty as the overall interpretation will depend on the adoption positions taken by each jurisdiction at ratification, acceptance, or approval of the MLI.[468]

The ATO is preparing a synthesised text for the majority of Australia's tax treaties modified by the MLI. When the ATO has published a synthesised text, it can be accessed from the ATO website. The following reference is to the ATO's synthesised text of the MLI and refers by way of example to the convention between Australia and Canada for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income as amended by the amending protocol.[469]

5.4 Specific Anti-Avoidance Rules

5.4.1 Transfer Pricing Rules

In taxation and accounting, transfer pricing refers to the rules and methods for pricing transactions 'when part of a multinational group buys or sells products or services from or to another part of the group in a different country'.[470] Because of the potential for cross-border controlled transactions to distort taxable income, tax authorities in many countries can adjust intragroup transfer prices that differ from what would have been charged by unrelated enterprises dealing at arm's length (the arm's-length principle).[471]

Lohse et al contend that as the number of MNEs increases, the number of transactions between entities belonging to the same multinational group will also rise, proportionally. They suggest that intercompany transactions provide the opportunity for management to shift income from one country to another, an activity often driven by tax aspects, such as a tax rate differential, or tax losses.[472]

The OECD has promoted dialogue and cooperation between governments and multinationals on tax matters and, consequently, on 16 August 2010 published the *Transfer Pricing Guidelines,* which contain the international criterion for 'securing the appropriate tax base in each jurisdiction and avoiding double taxation, thereby minimising conflict between tax administrations and promoting international trade and

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[468] Ibid.

[469] ATO, *Synthesised text of the MLI and the convention between Australia and Canada for the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income as amended by the amending protocol* <https://www.ato.gov.au/law/view/pdf/mli/canada.pdf>.

[470] Deutsch et al (n 360).

[471] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing, 2017) 17.

[472] Theresa Lohse, Nadine Riedel, and Christoph Spengel, *The Increasing Importance of Transfer Pricing Regulations – A Worldwide Overview* (Working Paper 12/27, Oxford University Centre for Business Taxation, Oxford, 2012) 1.

investment'.[473] Transfer pricing rules allocate business profits between countries and apportion those profits among different parts of a multinational group.[474]

In 2012, Professor Kerrie Sadiq of the University of Queensland wrote, quoting the Honourable Bill Shorten MP (as he then was), that Australia would be undertaking a reform of the 'transfer pricing rules in the income tax law and Australia's future tax treaties to bring them into line with international best practice, improving the integrity and efficiency of the tax system'.[475]

Ongoing work carried out by the OECD on aggressive tax planning has encouraged governments to respond more quickly to tax risks to tax revenue. The *Forum on Harmful Tax Practices* has built support for fair competition with more than 40 potentially harmful member country regimes abolished or modified.[476]

Following the statement of MP Bill Shorten in 2012, legislation enacted in 2013 modernised Australia's transfer pricing rules and more closely associated them with the OECD's *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations*.[477] The modernised rules seek to avoid the underpayment of tax in Australia by having multinationals price international-related party dealings as they would dealings with independent parties. Pricing for international dealings between related parties should reflect the correct return for the activities carried out in Australia, the Australian assets used (whether sold, lent, or licensed), and the risks assumed in carrying out these activities. Pricing not in accordance with Australia's transfer pricing rules is often referred to as 'international profit shifting'.[478]

Australia's double tax agreements and domestic law require pricing of goods and services and allocation of income and expenses between related parties to accord with the arm's length principle. Australia's cross-border transfer pricing rules are contained in Division 815 of ITAA 1997.[479] The *Tax Laws Amendment Act*

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[473] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (OECD Publishing, 2010) 18.

[474] Ibid.

[475] Kerrie Sadiq, 'The Inherent International Tax Regime and its Constraints on Australia's Sovereignty' (2012) 31(1) *University of Queensland Law Journal* 131.

[476] OECD, *Forum on Harmful Tax Practices*. The OECD started work on addressing harmful tax competition in the late 1990s, resulting in the 1998 report *Harmful Tax Competition: An Emerging Global Issue* (n 69). It also created the Forum on Harmful Tax Practices (FHTP) to take this work forward.

In Action 5 of the OECD/G20 Action Plan, the OECD builds on the conclusions of the 1998 Report. It expands the role of the Forum on Harmful Tax Practices FHTP, (established by the 1998 Report) by committing the FHTP to 'revamp the work on harmful tax practices.' The FHTP is asked to focus particularly on defining substantial activity as a requirement for any preferential regime; improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes; and evaluating preferential tax regimes in the BEPS context.

[477] Deutsch et al (n 360) 1392

[478] Australian Taxation Office, *International Transfer Pricing – Concepts and Risk Assessment* <https://www.ato.gov.au/print-publications/international-transfer-pricing---introduction-to-concepts-and-risk-assessment/> ('*International Transfer Pricing*').

[479] *Income Tax Assessment Act 1997* (Cth).

Amendment (Countering Tax Avoidance and Multinational Profit Shifting) 2015[480] modernised and relocated Subdivisions 815-B, 815-C and 815-D of ITAA 1936 into ITAA 1997, to ensure that consistent rules apply to both tax treaty and non-tax treaty cases.

Moreover, Subdivision 284-E of Schedule 1 to the *Tax Administration Act 1953*[481] which contains rules related to transfer pricing documentation, was also amended. Consistent with the approaches under Division 13, the new rules in Subdivision 815-B apply the arm's length principle to relevant dealings between both associated and non-associated entities. This better aligns Australia's domestic transfer pricing rules with the design of Australia's overall tax system, which largely operates on a self-assessment basis. As with the rules they replaced, the application of the transfer pricing rules in Division 815 is independent of any requirement for an entity to have a purpose of tax avoidance.[482]

Pursuant to Subdivision 815-B, the arm's length conditions between entities (whether separate entities or related) are substituted for the actual conditions if the actual conditions would result in an entity getting a transfer pricing benefit. Australia's current transfer pricing rules do not prescribe specific pricing methodologies. Rather, they authorise the use of a method or combination of methods that are appropriate and reliable regarding all relevant factors.[483] This approach reflects the framework set out in the OECD Guidelines.[484] The ATO accepts the comparable price method, the resale price method, and the cost-plus method as acceptable methodologies for the purposes of determining an arm's-length price involving property (including intangibles) or services.[485]

A transfer pricing adjustment can be made under Subdivision 815-B, Subdivision 815-C, or under the transfer pricing provisions of the relevant double tax agreement ('DTA'). An adjustment under either Subdivision will result in the same outcome as through the application of the transfer pricing articles of a DTA, to the extent that Subdivisions 815-B and 815-C have the same coverage. Where there are discrepancies between a relevant DTA and Subdivisions 815-B or 815-C, the DTA has priority.[486]

The *Tax Laws Amendment Act Amendment (Countering Tax Avoidance and Multinational Profit Shifting) 2015*[487] modernised Australia's transfer pricing regime by introducing a fundamentally different transfer

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[480] *Tax Laws Amendment Act Amendment (Countering Tax Avoidance and Multinational Profit Shifting) 2015* (Cth).

[481] *Tax Administration Act 1953* (Cth).

[482] See generally Deutsch et al (n 359) 1389–1392.

[483] *International Transfer Pricing* (n 478).

[484] OECD, *Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations* (n 470).

[485] Ibid.

[486] *International Tax Agreements Act 1953* (Cth), s 4(2).

[487] *Tax Laws Amendment Act*.

pricing environment with the intention of toughening Australian transfer pricing rules. Some of the key features of the legislation are:

1. The modernised rules are more focused on applying arm's-length principles than the former Division 13.[488]
2. Section 815-115 of Subdivision 815-B enables the ATO to substitute arm's length for actual conditions in dealings between separate entities.[489]
3. Subdivision 815-C applies where a taxpayer receives a transfer pricing benefit from attributing profits to a PE. The taxpayer is required to substitute the arm's-length profits of the PE for the profits attributed.[490]
4. Subdivision 815-B of ITAA 1997 operates on a self-assessment basis and is designed to counter the ATO's 'significant losses' in the decisions in *Federal Commissioner of Taxation v SNF (Australia) Pty Ltd*[491] and *Roche Products Pty Ltd v Federal Commissioner of Taxation*[492]. As such, they allow for profit-based testing of transfer pricing by requiring a company to identify if it has received a 'transfer pricing benefit'. A company must determine this by looking at the 'conditions that operate between an entity and another entity in connection with their commercial or financial relations' (the 'actual conditions') and comparing these with the 'conditions that might be expected to operate between independent entities dealing wholly independently with one another in comparable circumstances' (the 'arm's-length conditions').

The transfer pricing guidelines contained in Actions 8-10 of the OECD/G20 BEPS Action Plan Final Reports, which consists of revising the existing standard, have been incorporated into Australia's transfer pricing law by the *Tax Laws Amendment Act Amendment (Countering Tax Avoidance and Multinational Profit Shifting) 2013,* referred to above.

5.4.2 Neutralise Hybrid Mismatch Arrangements

Action 2 of the OECD/G20 BEPS Project is aimed at neutralising the effects of hybrid mismatch arrangements which come about in general because of different policy decisions that governments have made in relation to their tax systems.[493] A mismatch can occur when the tax laws of two countries treat documents or arrangements in a different manner, for example, when one country treats an arrangement as

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[488] Deutsch et al (n 360) 1393.

[489] Ibid.

[490] Ibid.

[491] *Federal Commissioner of Taxation v SNF (Australia) Pty Ltd* [2010] FCA 635.

[492] *Roche Products Pty Ltd v Federal Commissioner of Taxation* [2008] FCA 125.

[493] Deloitte, 'BEPS Actions Implementation by Country – Australia' <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-beps-actions-implementation-australia.pdf>.

debt, while the other country treats the same arrangement as equity. Other examples are when one country treats an arrangement as a sale, while the other treats it as borrowing or when one country treats an arrangement as an entity, while the other treats it as flow-through. Hybrid mismatch arrangements can result in double non-taxation, including long-term tax deferral. Such arrangements can reduce countries' collective tax base, although it may be difficult to determine which individual country has lost tax revenue.

The OECD has developed recommendations regarding the design of hybrid mismatch rules to be implemented as part of domestic legislation under Action 2 of the BEPS Action Plan. The OECD anti-hybrid rules operate to:

- deny deductions for the payer (or alternatively include taxable income in the hands of the payee) where an entity is able to claim a tax deduction in one jurisdiction but not include an income amount in the other tax jurisdiction; and
- deny duplicate deductions where an entity is able to claim a tax deduction in both tax jurisdictions for a single payment.

On 9 May 2017, the Australian government announced specific rules to eliminate hybrid mismatches that occur in relation to regulatory capital known as Additional Tier 1 (AT1), issued by regulated entities such as banks and insurers, by:

- preventing returns on AT1 capital from carrying franking credits where such returns are tax deductible in a foreign jurisdiction; and
- where the AT1 capital is not wholly used in the offshore operations of the issuer, requiring the franking account of the issuer to be debited as if the returns were to be franked.[494]

In March 2016, the Australian Board of Taxation published a report on the implementation of the OECD hybrid mismatch arrangement rules.[495] This report contained 17 recommendations, including the recommendation that legislation be prepared to implement the recommendations.[496] Submissions made to the Board supported restrictions being placed on the application of Part IVA in these circumstances; particularly given one of the explicit design principles of the hybrid mismatch rules is deterrence, for example, encouraging a restructure to remove hybrid financing.[497]

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[494] Commonwealth of Australia, 'Budget 2017-18', <https://archive.budget.gov.au/2017-18/bp2/bp2.pdf>.

[495] 'Implementation of the OECD hybrid mismatch rules', *Board of Taxation (Cth)* (Web Page, 2016) <https://taxboard.gov.au/consultation/implementation-of-anti-hybrid-rules>.

[496] Ibid 5.

[497] Ibid.

On 3 May 2016, the Australian Government confirmed that Australia will introduce anti-hybrid rules modelled on the OECD approach. Legislation to put this into effect has yet to be drafted. In 2017, the OECD published a further report on neutralising the effects of branch mismatch arrangements.[498]

5.4.3 Prevent Artificial Avoidance of Permanent Establishment

Australia's new Multinational Anti-Avoidance Law (MAAL)[499] is consistent with this item (see discussion later) and applies from 1 January 2016.[500] Other OECD recommendations are in line with Australia's treaty practice. The OECD/G20 BEPS Action 7 Report proposes changes to the permanent establishment (PE) definition in Article 5 of the OECD Model Tax Convention (the OECD Model) to prevent the use of the following arrangements that are considered to enable a foreign enterprise to operate in another country without creating a PE:

- commissionaire arrangements and similar strategies
- the use of specific preparatory or auxiliary activity exemptions, including the artificial fragmentation of so-called 'cohesive' business activities into several smaller operations such that each part is able to benefit from the use of such specific activity exemptions.[501]

The draft contents of the 2017 update to the OECD Model, published on 11 July 2017, contain substantial proposed amendments to Article 5, including amendments relating to commissionaire arrangements and artificial fragmentation of business activities. The Final Report also proposes the use of the Principal Purpose Test ('PPT') rule recommended under Action 6 to address tax strategies that involve the splitting-up of contracts between closely related enterprises.

5.4.4 Limit Thin Capitalisation and Rules to Prevent the Manipulation of Debt Location

Thin capitalisation is a term used to describe a practice whereby the interest deductions claimed by a multinational taxpayer are limited by a specified statutory ratio or formula.[502] Excessive debt loading is a practice employed by MNEs to reduce their overall tax liability. Money is mobile, which allows multinationals to shift debt into high-tax countries to obtain a tax deduction for the interest paid. This reduces the profits in the high-tax country, thereby reducing tax liability.[503]

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[498] OECD, 'Neutralising the Effects of Branch Mismatch Arrangements' (OECD/G20, Base Erosion and Profit Shifting Project, 2017) < https://www.oecd.org/tax/beps/neutralising-the-effects-of-branch-mismatch-arrangements-action-2-9789264278790-en.htm>.

[499] *Tax Laws Amendment Act Amendment*.

[500] Ibid.

[501] 'Action 7 Permanent establishment status', *OECD* (Web Page) <https://www.oecd.org/tax/beps/beps-actions/action7/>.

[502] Deutsch et al (n 360) 1399.

[503] Ibid 1399.

A thinly capitalised entity funds its assets in a country with a high level of debt and relatively little equity. An entity's debt-to-equity funding can be expressed as a ratio. For example, a ratio of 1.5:1 means that for every $3 of debt, the entity is funded by $2 of equity. This is also called 'gearing'. A highly geared entity funds its assets with proportionately more debt than equity.[504] A study conducted in 2014 by Professors Jennifer Blouin, Harry Huizinga, Luc Laeven, and Gaëtan Nicodème for the International Monetary Fund examined the impact of thin capitalisation rules that limit the tax deductibility of interest on the capital structure of the foreign affiliates of US multinationals. The authors of the study examined confidential data on the internal and total leverage of foreign affiliates of US multinationals in 54 countries for the period 1982-2004. The study found that thin capitalisation rules 'significantly affect multinational firm capital structure'.[505]

Thin capitalisation is a tax term used to describe circumstances in which 'a taxpayer has cross-border investments and the taxpayer's allowable interest deductions are limited by a specified statutory ratio or formula'.[506] Australia's thin capitalisation rules limit the amount of debt that can be used to fund the Australian operations of both foreign entities investing in Australia and Australian entities investing overseas.[507] The rules disallow debt deductions when an entity's debt-to-equity ratio exceeds certain limits. A debt deduction is an expense an entity incurs with a debt interest, such as an interest payment or a loan fee, which the entity would otherwise be entitled to claim as a deduction.[508]

Australia's thin capitalisation rules were amended by the *Tax and Superannuation Laws Amendment (2014 Measures No 4) Act 2014*.[509] These 2014–15 amendments include changes to safe harbour ratios, rules governing outward investors, rules governing inbound investors, and the *de minimis* threshold.[510]

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[504] Australian Taxation Office, *Thin Capitalisation*, https://www.ato.gov.au/business/thin-capitalisation/.

[505] Jennifer Blouin, Harry Huizinga, Luc Laeven, and Gaëtan Nicodème, 'Thin Capitalization Rules and Multinational Firm Capital Structure' (Working Paper WP/14/12, International Monetary Fund, 2014) 1.

'The study found that restrictions on an affiliate's debt-to-assets ratio reduced this ratio on average by 1.9%, while restrictions on an affiliate's borrowing from the parent-to equity ratio reduce this ratio by 6.3%. Also, restrictions on borrowing from the parent reduce the affiliate's debt-to-assets ratio by 0.8%, which shows that rules targeting internal leverage have an indirect effect on the overall indebtedness of affiliate firms. The impact of capitalisation rules on affiliate leverage is higher if their application is automatic rather than discretionary. Furthermore, thin capitalization regimes have aggregate firm effects: they reduce the firm's aggregate interest expense but lower firm valuation. Overall, our results show than thin capitalisation rules, which thus far have been understudied, have a substantial effect on the capital structure within multinational firms, with implications for the firm's market valuation'.

[506] Deutsch et al (n 360) 1399.

[507] Ibid 1400.

[508] Ibid.

[509] *Tax and Superannuation Laws Amendment (2014 Measures No 4) Act* 2014 (Cth).

[510] Deutsch et al (n 360) 1400.

Examples of debt interests include loans, bills of exchange, or a promissory note. The thin capitalisation rules apply to:

- outward investing entities — Australian entities with specified overseas investments
- inward investing entities — foreign entities with certain investments in Australia, regardless of whether they hold the investments directly or through Australian entities.[511]

Australia's first substantive thin capitalisation rules were introduced in 1987 by way of Division 16F of Part 111A ITAA 1936.[512] Division 16F was effectively replaced from 1st July 2001 by the wider rules contained in Division 820 of ITAA 1997.[513] There are 8 categories of entities that are subject to the Division 820 rules. In every case where the thin capitalisation rules are applied, some of the interest deductions that would be available, but for the application of the rules, are denied.[514]

On 2 October 2014, the Australian Senate referred an inquiry into corporate tax avoidance that included thin capitalisation to the Senate Economics References Committee for inquiry and report by the first sitting day in June 2015. The report of the Senate committee was eventually due on 30 September 2016 but was not delivered due to the 2016 Federal election. The committee's final report into corporate tax avoidance was delivered in 2017 under the title 'Much heat, little light so far'.[515]

5.4.5 Controlled Foreign Entity Rules

Controlled foreign company (CFC rules exemplify a unilateral measure that may secure the national tax base. Such unilateral measures may form a substitute for multilateral measures, like tax rate coordination, that would also preserve countries' abilities to tax mobile capital. Against the background of aggressive tax

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[511] Ibid.

[512] *Income Tax Assessment Act* 1936 (Cth).

[513] *Income Tax Assessment Act 1997* (Cth), s 820.1.

'This Division applies to foreign controlled Australian entities, Australian entities that operate internationally and foreign entities that operate in Australia.

Financing expenses that an entity can otherwise deduct from its assessable income may be disallowed under this Division in the following circumstances:

- for an entity that is not an authorised deposit-taking institution for the purposes of the *Banking Ac1959* (an ADI) - the entity's debt exceeds the prescribed level (and the entity is therefore "thinly capitalised");
- for an entity that is an ADI--the entity's capital is less than the prescribed level (and the entity is therefore "thinly capitalised")".

[514] Deutsch et al (n 360) 1401.

[515] 'Corporate Tax Avoidance', Parliament of Australia (Web Page) <http://www.aph.gov.au/Parliamentary_Business/Committees/Senate/Economics/Corporatetax45th>.

avoidance by multinationals like Starbucks, Google, and Amazon, the OECD called for a strengthening of CFC rules by OECD Member countries (Action 3 of the OECD Action Plan on BEPS).[516]

Whether unilateral action is working is essentially a practical question. There are two studies that indicate the impact of CFC rules on the decisions of multinationals that allocate passive assets. In 2003, Altshuler and Hubbard analysed the United States *Tax Reform Act of 1986*, which changed the United States CFC rules (Subpart F provisions) and made it more difficult to defer home taxation of passive overseas income.[517] The analysis revealed that the legislative tightening of the CFC rules reduced the attractiveness of low-tax countries to multilateral enterprises, measured by the aggregated sum of financial assets received.[518]

The CFC rules apply to certain base eroding or 'tainted' income derived by a non-resident-controlled entity. This income is attributed to, and currently taxed to, the domestic shareholder's other income, regardless of whether the income has been repatriated to them. Australia's controlled foreign entity rules are contained in Subdivision B of Part X of ITAA 1936 and apply to controlled foreign companies (CFC), controlled foreign partnerships (CFP), and controlled foreign trusts (CFT).[519] Sections 340 and 361 of ITAA 1936 contain the tests to determine whether a company is a CFC at a particular time and whether an entity is an attributable taxpayer at a particular time.[520]

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[516] Martin Ruf and Alfons J. Weichenrieder, *CFC Legislation, Passive Assets, and the Impact of the ECJ's Cadbury-Schweppes Decision,* (CESifo Working Paper No. 4461, October 2013), 2.

[517] *Tax Reform Act of 1986,* USC 26.

[518] Rosanne Altshuler and Glenn Hubbard, 'The effect of the tax reform act of 1986 on the location of assets in financial services firms' (2003) 87(1) *Journal of Public Economics* 109–127.

[519] *Income Tax Assessment Act 1936* (Cth).

[520] A company is a CFC at a particular time if, at that time, the company is a resident of a listed country or of an unlisted country and any of the following paragraphs applies:

(a) at that time, there is a group of 5 or fewer Australian 1% entities the aggregate of whose associate-inclusive control interests in the company is not less than 50%;

(b) both of the following subparagraphs apply:

(i) at that time, there is a single Australian entity (in this paragraph called the assumed controller) whose associate-inclusive control interest in the company is not less than 40%; (ii) at that time, the company is not controlled by a group of entities not being or including the assumed controller or any of its associates;

(c) at that time, the company is controlled by a group of 5 or fewer Australian entities, either alone or together with associates (whether or not any associate is also an Australian entity).

Section 361 contains the tests for determining whether an entity is an attributable taxpayer at a particular time:

(1) An entity (in this subsection called the test entity) is an attributable taxpayer in relation to a CFC at a particular time if, at that time:

(a) the test entity is an Australian entity whose associate-inclusive control interest in the CFC is at least 10%; or

(b) all of the following subparagraphs apply:

(i) the CFC is a CFC at that time only because of paragraph 340(c);

Section 404, ITAA 1936 provides that where the eligible controlled foreign entity (CFE) is a resident of a listed country or a section 404 country at the end of the eligible period, a dividend paid to it in the eligible period by a company that is a resident of a listed country or a section 404 country is notional exempt income.

These CFE measures require Australian taxpayers to include in their assessable income a share of income or gains earned by foreign companies in which they have a controlling interest. This is required even though the income or gains are retained by the controlled foreign company and have not been received by the taxpayer.[521] The attributable income of a CFE is calculated pursuant to sections 381 to 431A of Division 7 of Part X of ITAA 1936. The attributable income is calculated on the basis that the CFE is a resident Australian company.

The work performed by the OECD in association with G20 identified four areas of tax avoidance specifically dealt with in the MLI and identified in this paper as essential components of an MTT. Action 6 of the BEPS Action Plan is concerned with the development and implementation of anti-avoidance provisions and recommendations regarding the design of domestic laws to prevent the granting of treaty benefits in inappropriate circumstances.[522] The OCED and jurisdictional tax departments will also work to ensure that tax treaties are not used to generate double non-taxation and identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be coordinated with the work on hybrids.[523]

Treaty abuse is one of the most important causes of BEPS concerns. The Commentary on Article 1 of the OECD Model Tax Convention already includes several examples of provisions that could be used to address treaty-shopping situations and other cases of treaty abuse that may give rise to double non-taxation. The provisions of the MTT should include tight treaty anti-abuse clauses that, coupled with the exercise of taxing rights under domestic laws, will contribute to the restoration of source taxation.[524]

(ii) the CFC is controlled by any group of 5 or fewer Australian entities, either alone or together with associates (whether or not any associate is also an Australian entity); (iii) the test entity is an Australian 1% entity and is included in that group of 5 or fewer Australian entities.

(2) An entity (in this subsection called the test entity) is an attributable taxpayer in relation to a CFT at a particular time if, at that time, the test entity is an Australian entity whose associate-inclusive control interest in the CFT is at least 10%. (3) Subsections (1) and (2) have effect subject to section 768-960 of the *Income Tax Assessment Act 1997*.

[521] Deutsch et al (n 360) 1335.

[522] Ibid.

[523] Ibid.

[524] Ibid.

5.5 General Anti-Avoidance Rules

Associate Professor Anthony Ting of the University of Sydney investigated the effectiveness of Australia's anti-avoidance rules as he considered it doubtful whether the BEPS Project would be a complete success.[525] He proposed that Australia should continue its support of the OECD's BEPS Project, which attempts to garner consensus on methods to address the BEPS issues.[526] In addition, the BEPS Project focuses on CFE[527] and transfer pricing[528], which are specific anti-avoidance rules. Ting also advanced the proposition that Australia should consider unilateral actions to complement the international effort. Specifically, he suggested that a 'strengthened Part IVA may function in the manner of a backstop for aggressive BEPS structures that are not effectively addressed by the OECD BEPS Project'.[529] Ting observed that under current tax laws, tax treaties cannot prevent the application of Part IVA pursuant to Section 4(2) of the *International Tax Agreements Act 1953*.[530] Ting suggested that it may be possible to strengthen the international tax regime to effectively address the BEPS issues without contradicting Australia's tax treaties.[531]

Many countries, including Australia, Belgium, Canada, China, France, Germany, Kenya, Singapore, South Africa, The Netherlands, and United Kingdom, have introduced a general anti-avoidance rule. The introduction of a GAAR also continues to be topical in many other jurisdictions such as India[532] and Poland[533]. Italy also recently enacted its first modern GAAR.[534]

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[525] Ibid.

[526] Anthony Ting, 'Submission to Senate Economics Legislation Committee – Inquiry into Tax Laws Amendment (Combating Multinational Tax Avoidance) Bill 2017 and Diverted Profits Tax Bill 2017)' <https://www./aph.gov.au>.

[527] *Income Tax Assessment Act 1936* (Cth), Subdivision B.

[528] *Tax Laws Amendment Act Amendment (Countering Tax Avoidance and Multinational Profit Shifting) 2013* (Cth).

[529] Ting (n 526).

[530] *International Tax Agreements Act 1953.*

4.2 The provisions of this Act have effect notwithstanding anything inconsistent with those provisions contained in the Assessment Act (other than Part IVA of the *Income Tax Assessment Act 1936*) or in an Act imposing Australian tax.

[531] Ting (n 526).

[532] In India, the applicability of its GAAR is to be deferred by 2 years in accordance with the announcement in the Budget for fiscal year 2015-16 which was presented to Parliament by the finance minister on 28 February 2015. Accordingly, the GAAR would be applicable from the financial year 2017-18. Further, when implemented, the GAAR will apply prospectively to investments made on or after 1 April 2017.

[533] On 27 April 2015, the amended version of the proposed Tax Code (Ordynacja Podatkowa) was published in Poland which no longer contains the provision of general anti-avoidance rules (GAARs) that were planned to be introduced into the tax system.

[534] In Italy, the new GAAR was introduced with the Legislative Decree n. 128 of 2015 and was effective from 1 October 2015.

Australia's GAAR is contained in Part IVA of the *Income Tax Assessment Act 1936* (Cth) (ITAA 1936). A series of cases which went against the Commissioner of Taxation[535] led to the passing of the *Tax Laws Amendment Act Amendment (Countering Tax Avoidance and Multinational Profit Shifting) 2013* (Cth) to ensure the effective future operation of the income tax general anti-avoidance provision. The principal role of Part IVA is to counter arrangements that, objectively viewed, are carried out with the sole or dominant purpose of securing a tax advantage for a taxpayer. Part IVA operates to counter such arrangements by exposing the substance or reality of the arrangements to the ordinary operation of the income tax law. Several decisions by the Full Federal Court of Australia prior to June 2013 caused the Australian Government to be concerned that Section 177C of Part IVA contained weaknesses that reduced the effectiveness of Part IVA.[536]

The amendments consisted principally of amending Section 177C, deleting Sections 177CA and 177D, and substituting new Sections 177CB and 177D. In part, the weaknesses in the reconstruction limb of Subsection 177C(1) may have been an unintended consequence of the way that Section 177D approached the question of whether Part IVA applies to a scheme. Under Part IVA prior to June 2013, the first question to determine whether Part IVA applied was whether a taxpayer had obtained a tax benefit in connection with the scheme (as defined in section 177C). Only if the answer was 'yes', did attention turn to the Section 177D inquiry and the question whether a participant in the scheme had the dominant purpose of securing a tax benefit for the taxpayer in connection with the scheme.

For instance, in *RCI Pty Limited v Commissioner of Taxation*, the Full Court of the Federal Court concluded it was 'strictly unnecessary', in disposing of that matter, for it to consider the paragraph 177D(B) issue as to the purpose (although it did, in fact, go on to consider the issue out of 'deference to the primary judge's reasons and to the submissions on the hearing of the appeal').[537] Similarly, the Full Court of the Federal

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[535] See, eg, *Federal Commissioner of Taxation v SNF (Australia) Pty Ltd* [2010] FCA 635 and *Roche Products Pty Ltd v Federal Commissioner of Taxation* [2008] FCA 125.

[536] Deutsch et al (n 360).

[537] *RCI Pty Limited v Commissioner of Taxation* [2011] FCAFC 104 [151].

Extract from ATO Decision Impact Statement 27 August 2012 as amended 7 November 2016.

Relevant Ruling/Determination:

TD 2003/3 - Income tax: Can Part IVA of the Income Tax Assessment Act 1936 (the '1936 Act') apply to a 'Capital Gains Tax reduction arrangement' of the type described in this Taxation Determination?

In paragraph 151 the Court noted that having found that there was no tax benefit obtained by the taxpayer in connection with the scheme it was not strictly necessary for it to make any finding about dominant purpose, but in the event that Stone J (trial judge) was correct, the Full Court went on to discuss dominant purpose at paragraphs 152-169.

In paragraph 169 the Court said that the only objective indicia that arguably would suggest that the relevant parties had entered the transaction for the dominant purpose of tax avoidance was the size of the dividend, being US$318 million. However, the size of the dividend was explicable for other reasons as contended by RCI, and therefore it could not be concluded (by reference to a

Court in *FCT v Futuris Corporation* dismissed the commissioner's appeal without considering the question of whether any person had the relevant tax avoidance purpose.[538] The government considered this approach as undesirable from a policy perspective. Gummow and Hayne JJ indicated in *Commissioner of Taxation v Hart* that Subsection 177C(1) and paragraph 177D(B) must be read together and agreed with Hill J that the substance of the arrangement, in form of two separate loans, was, in fact, one advance to be repaid by 300 instalments.[539]

The amendments to Section 177C clarify the definition of 'the obtaining by a taxpayer of a tax benefit in connection with a scheme'. The new Section 177CB sets out the bases for identifying tax benefits while Section 177D defines the schemes to which Part IVA applies.

5.6 Withholding Taxes

A withholding tax, also called a retention tax, is a government requirement for a taxpayer to withhold or deduct tax from the payment of a specified amount, where the circumstances of the payment are such that the government considers withholding tax as a condition for the protection of its tax base. Many jurisdictions also require withholding tax on payments of interest, dividends, and royalties.[540] Most countries impose withholding tax obligations if the income recipient is a resident in another country.[541]

Withholding tax is an advance payment of the recipient's final tax liability, with the withholding made in advance. The tax withheld may be refunded if it is determined, when a tax return is filed, that the recipient's tax liability to the government which received the withholding tax is less than the amount of tax withheld. Conversely, additional tax may be payable if it is determined that the recipient's tax liability exceeds the amount of the tax withheld. 'Final withholding' occurs in some cases where the withholding tax is treated as discharging the recipient's tax liability, and no lodging of a tax return or the payment of additional tax is required.[542]

Professors Yariv Brauner and Andres Baez Moreno considered the role of withholding taxes in relation to taxing the digital economy in 2015 in a position paper of the IBFD Academic Task Force.[543] The paper

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balanced consideration of the eight factors contained in s177D(b)) that the relevant parties had entered into the transaction for the dominant purpose of tax avoidance.

In paragraph 170 the Court said that, if it was incorrect about the taxpayer not having obtained a tax benefit in connection with the scheme, it would as a result of the above also have come to a different conclusion to the primary judge in relation to the evidence on dominant purpose.

[538] *FCT v Futuris Corporation* [2012] FCAFC 32 [81].

[539] *Commissioner of Taxation v Hart* [2004] HCA 26.

[540] Deutsch et al (n 360) 1338.

[541] Ibid.

[542] Ibid.

[543] Brauner and Baez Moreno (n 389).

related to the OECD's work on BEPS Action 1 and investigated possible solutions to the challenges presented to the international tax regime by the digital economy. The paper considered both the option of installing a withholding tax mechanism as the primary response to these challenges and the option of using withholding taxes in support of a nexus-based solution. Brauner and Baez Moreno advocated introducing 'a broad withholding mechanism based upon the base erosion principal both as a primary response to these challenges or in support of a new nexus-based solution'.[544] Consequently, they proposed 'a globally standard 10% final withholding tax on all base-eroding business payments to registered non-residents, with specific, again globally standard, exemptions to payees registered to be taxed under a net taxation scheme'.[545]

A 'dividend' is defined in Section 6(1) of Australia's ITAA 1936 and supplemented by Subsections 6 BA(5) and 94L of Section 995-1. A payment to a taxpayer is subject to withholding tax if it is:

1. a dividend
2. income
3. derived by a foreign resident
4. not exempt from withholding tax.

The debt/equity rules in Division 974 ITAA 1997 must also be taken into consideration to decide if a return on an investment is a return on debt (debt interest) or equity (equity interest). If it is a return on debt interest, it will be subject to withholding tax in appropriate cross-border circumstances. If it is a return on equity interest, the dividend withholding tax provisions will apply. Returns on interest classified as debt are generally deductible, non-frankable, and subject to an interest withholding tax of 10% of the gross amount paid to a foreign resident.[546] In *Deutsche Asia Pacific Finance Inc v FCT (No 2)*[547] the taxpayer's interest in a limited partnership in New South Wales was considered to be a 'debt interest', and so, distributions received by the taxpayer were 'interest' and not subject to withholding tax because of the operation of the Australia/USA double tax agreement.[548]

5.7 Multilateral Instrument

On 7 June 2017, the OECD hosted a signing ceremony in Paris, France for the *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*. Commonly referred to as the 'Multilateral Instrument' or MLI. The MLI was developed pursuant to Action 15 of the BEPS Action Plan 'to implement the BEPS treaty-related measures and amend bilateral tax treaties'.[549] The MLI was

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[544] Ibid.

[545] Ibid 2.

[546] Deutsch et al (n 360) 1340.

[547] *Deutsche Asia Pacific Finance Inc v FCT (No 2)* (2008) 73 ATR 1.

[548] Deutsch et al (n 360) 1340.

[549] 'Explanatory Statement' (n 7).

intended to provide a simplified mechanism for the implementation of the BEPS program which did not involve the laborious negotiation of each treaty. The MLI was signed by 67 signatories covering 68 jurisdictions.[550]

On 24 November 2016, the OECD released a text version of the MLI with an accompanying Explanatory Statement. This document contains 39 Articles which have been negotiated by an ad hoc group of 99 countries. The Articles were divided into seven parts. Two parts involve scope, interpretation, and implementation. One part — Part VI — involves an option for mandatory binding arbitration. The remaining four parts deal with any recommendations for changes in treaties in the OECD Action Plan. This covers:

1. hybrids (Action 2)
2. treaty abuse (Action 6)
3. permanent establishments (Action 7)
4. dispute resolution (Action 14).[551]

These recommendations contain significant flexibility although the options provided are not open but are very specific.

The 7 June meeting and signing ceremony provided a forum in which countries could publicly state their positions on various options contained in the MLI by lodging a document outlining a provisional list of reservations and notifications (their 'MLI Position') at the time of signature. A key document released on 7 June 2017 contains three pages of links leading to a template of notifications completed by each country. These completed templates vary in size, but most are about thirty pages long.[552] Whilst the OECD may have found a means to amend multiple treaties, it is not yet established whether these processes comply with international law and taxation law.

According to the OECD, the MLI allows countries to swiftly amend existing tax treaties to oppose tax avoidance strategies and to put an end to treaty abuse and 'treaty shopping' by transposing into existing tax treaties a commitment to include certain anti-avoidance tools.[553]

5.8 Conclusion

This chapter examined key anti-avoidance measures in operation to counter BEPS. The examination revealed that the OECD has responded to OECD and G20 members' complaints about the increasing incidence of BEPS, but the OECD Action Plan has many issues to overcome yet. For example:

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[550] KPMG, 'ASPAC and the Multilateral Instrument', 3 <https://home.kpmg.com/content/dam/kpmg/au/pdf/2017/aspac-multilateral-instrument-treaty-related-beps-provisions.pdf>.

[551] Ibid 6.

[552] Ibid 6.

[553] *Multilateral Convention to Prevent BEPS* (n 322) 3.

- The international tax environment is unstable and uncertain. An avalanche of reports from the OECD has failed to obscure the increasing failure of the international tax regime, based on the OECD Model Convention, to deal with the tax challenges resulting from the continued globalisation and the digital economy. Continuing global economic uncertainty increases pressure on governments to reduce spending while maintaining services.
- Increased regulation and changing tax legislation following the implementation of the OECD/G20 BEPS Action Plan have led to changes in regulatory and fiscal policies, with companies expected to improve their governance, accountability, and transparency, which will increase costs for both MNEs and taxation authorities.

Multinationals must be cognisant of the application of these changes to global tax strategies and operating models and recognise the importance of designing and implementing a coherent tax strategy, tax policy, and risk framework to enable the effective management of taxes.

The OECD/G20 BEPS Action Plan, although well designed and implemented, may be destined to be just another round in the ongoing battle between developed and developing governments and multinationals for temporary tax supremacy. The introduction of a minimum tax rate for large multinationals will arguably buttress the tax base of resident tax jurisdictions from jurisdictions offering tax rates below 15%. This is arguably political and may tend to protect the tax outcomes of developed jurisdictions. Until the OECD acknowledges that the OECD Model has become redundant and that a multilateral treaty is inevitable to successfully manage current and future tax developments, multilaterals will likely remain in the ascendancy, the OECD will be fully occupied churning out anti-avoidance reports, and BEPS will continue to increase.

The following chapter introduces the multilateral instrument.

CHAPTER 6: THE MULTILATERAL INSTRUMENT

6.1 Introduction

The BEPS Action Plan Action 15 amending instrument came into force on 7 June 2017. The multilateral tax instrument (MLI) is designed to reduce BEPS by MNEs by simplifying the process of amending bilateral tax treaties.[554] The text and commentary of the MLI had been published in November 2016 by the OECD.[555] The OECD stated:

> The Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS will implement minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies. It will also allow governments to strengthen their tax treaties with other tax treaty measures developed in the OECD/G20 BEPS Project. The new instrument will transpose results from the OECD/G20 Base Erosion and Profit Shifting Project (BEPS) into more than 2,000 tax treaties worldwide.[556]

The MLI is unquestionably a ground-breaking instrument that resulted from a multitude of OECD research reports, beginning with *Addressing the Challenges of the Digital Economy* in 2013.[557] The MLI raises questions relating to the text of the treaty provisions, how the MLI will interact with tax treaties, and what impact it will have on the future development of the global corporate tax regime and international cooperation in tax matters.[558] The OECD acknowledged that the MLI utilised the same design as that employed in designing the 2003 *Agreement on Extradition,* which modified extradition treaties between the United States of America and individual European countries.[559]

This chapter focuses on three aspects of the MLI. Firstly, in order to establish a contextual background to the development of the OECD/G20 BEPS Action Plan that fashioned the MLI, the prevailing economic factors that likely triggered the development of the MLI are briefly examined. Secondly, the chapter deals with the design and structure of the MLI, including the many options available to the contracting states under the MLI. Thirdly, it examines the operational processes of the MLI to assess the likely effectiveness of the MLI

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[554] 'Ground-breaking multilateral BEPS convention signed at OECD will close loopholes in thousands of tax treaties worldwide', *OECD* (Web Page, June 7, 2017) <http://www.oecd.org/tax/ground-breaking-multilateral-beps-convention-willclose-tax-treaty-loopholes.htm>.

[555] *Multilateral Convention to Prevent BEPS* (n 322).

[556] 'Countries Adopt Multilateral Convention to Close Tax Treaty Loopholes and Improve Functioning of International Tax System', *OECD* (Wep Page, 24 November 2016) <http://www.oecd.org/tax/countries-adopt-multilateral-convention-to-close-tax-treaty-loopholes-and-improve-functioningof-international-tax-system.htm>.

[557] *Addressing Base Erosion and Profit Shifting* (n 23).

[558] Ibid.

[559] OECD, 'Legal Note on the Functioning of the MLI under Public International Law' <http://www.oecd.org/taxtreaties/legal-note-on-the-functioning-of-theMLI-under-public-international-law.pdf>.

in reducing BEPS. This is extended to an assessment of the operational processes of the MLI in Chapter 7 of this thesis.

The strategy underlying the MLI is to have available a single instrument which allows any jurisdiction that has signed up to update its bilateral tax treaties by a relatively simple process of domestic ratification, acceptance, or approval pursuant to the domestic laws of both countries that are parties to each treaty.[560] When the relevant notifications have been lodged with the OECD, the amendments take effect without each treaty having to be re-negotiated individually, which is a much more time-consuming and costly process.[561] Consequently, the MLI's design had to include sufficient flexibility to enable amendment of the thousands of bilateral treaties based on different treaty models, some already containing an amending provision, such as an arbitration clause.[562] The current bilateral treaties are of varying scope, age, languages, and protocols and exist between countries that have different domestic laws and views on implementation beyond the BEPS compulsory minimum standards (which only concern three articles of the MLI).[563]

The substance of the tax treaty-related BEPS measures (under BEPS Actions 2, 6, 7 and 14) was agreed on as part of the Final BEPS package.[564] Accordingly, the negotiations on the text of the MLI were focused on the amendments to bilateral tax treaties required to implement those BEPS measures.[565]

6.2 Economic Factors That Contributed to the Development of the Multilateral Instrument

The financial crisis of 2007–2008, also known as the global financial crisis (GFC), was a severe worldwide financial crisis. Excessive risk-taking by banks[566] combined with the bursting of the US housing bubble[567] caused securities tied to US real estate that had been packaged as real estate bonds to plummet, and the consequent fallout severely damaged financial institutions globally.[568]

Arguably, the financial crisis engendered by the GFC applied pressure on OECD Member countries and G20 countries to recover from the GFC by improving tax collection from the corporate sector. The following

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[560] See, eg, Cooper (n 118) 4.

[561] Richard Vann and Steven Guo, 'Multilateral instrument and treaties presentation' (21 September 2017), *The Tax Institute* (New South Wales Division) < https://www.taxinstitute.com.au/tiseminarpresentation/multilateral-instrument-and-treaties-presentation>.

[562] See for example, Rhiain Garrihy and Chris Stewart, 'The changing nature of double tax treaties', (30-31 May 2019) *The Tax Institute* (Queensland Division).

[563] Vann (n 4).

[564] 'Explanatory Statement' (n 7).

[565] Ibid.

[566] Luc Laeven and Fabian Valencia, 'Systemic Banking Crisis: A New Database' (Working Paper 08/224, International Monetary Fund, November 2008).

[567] Graeme Wearden, 'The Case–Shiller home price index reported its largest price drop in its history' *The Guardian* (London, 30 December 2008).

[568] Ibid.

year, the OECD published *Addressing Base Erosion and Profit Shifting,* which analysed the extent of tax loss attributable to BEPS.[569]

The OECD itself lacks the power to act other than as global tax advisor. It makes recommendations that can only be implemented by putting through changes to the double tax treaties. The MLI, developed by the OECD and endorsed by the G20, offers solutions for governments to close the gaps in existing international tax rules by transposing results from the OECD/G20 BEPS Project into the worldwide network of bilateral tax treaties. The MLI is intended to modify the application of thousands of bilateral tax treaties concluded to eliminate double taxation, without creating opportunities for double non-taxation or less-than-single taxation through tax evasion or avoidance.[570]

6.3 Design of the Multilateral Instrument

The OECD adopted an innovative design for an instrument that would, if generally accepted by countries and jurisdictions, enable the fast-tracked amendment of the bilateral tax treaty network to strengthen and align the global BEPS anti-avoidance laws. Jurisdictions and the OECD wanted a quick implementation to entrench the proposals, with all the implications for tax treaties (rather than domestic law) that would arise out of the BEPS Project. Modifying the OECD model was easily achievable; however, this has no direct effect on existing treaties, only possible on future treaties.[571]

The MLI is designed to achieve the following results:

- provide a mechanism for expeditiously amending the tax treaty network
- introduce anti-avoidance provisions into bilateral tax treaties
- prevent treaty abuse.[572]

The OECD claims the MLI is not designed to function identically to an amending protocol to a single existing treaty, which would directly amend the content of the existing tax treaty.[573] Instead, the MLI is designed to operate in conjunction with the existing tax treaties. As stated in the Explanatory Statement,[574] the MLI adopts the ordinary rule of treaty interpretation, set forth in Article 30(3) of the *Vienna Convention on the Law of Treaties*, under which an earlier treaty between parties that are also parties to a later treaty will

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[569] *Addressing Base Erosion and Profit Shifting* (n 23).

[570] 'Multilateral Instrument (MLI) – Big Bang in Tax Treaties', PFPC Global (Web Page, 4 February 2019) <https://pfpcglobal.com/en/multilateral-instrument/>.

[571] Ibid.

[572] Ibid 3–7.

[573] Ibid 23.

[574] 'Explanatory Statement' (n 7).

apply only to the extent that its provisions are compatible with those of the later treaty.[575] With one convention, the signatory countries can achieve a result that otherwise may have taken many years to complete.[576] However, the processes involved will make it difficult, if not impossible, to determine the compatibility of the provisions of the earlier and later treaties.[577]

Consistent with the overriding purpose of the MLI, which is to expeditiously implement the tax treaty-related BEPS measures, the MLI also enables all parties to meet two of the four minimum standards which were agreed on as part of the Final BEPS Package.[578] Given that each of those minimum standards can be satisfied in multiple different ways and taking into consideration the number of jurisdictions involved in the development of the MLI, the OECD has argued that the MLI must provide flexibility regarding how it is applied to individual tax treaties while remaining consistent with its purpose. The OECD further argues that the MLI provides flexibility by allowing countries to opt out of provisions which do not reflect a BEPS minimum standard.[579]

The legal note which the OECD released describes the MLI as amounting to 'an "open offer" by a jurisdiction to its listed treaty partners to modify bilateral tax treaties in line with its MLI Position'.[580] The MLI only applies to CTAs that are listed by the Contracting Jurisdictions to those agreements.[581] A party may choose to exclude recently renegotiated agreements in certain circumstances.[582] Further, the parties can

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[575] *Vienna Convention* (n 34).

Article 30 (3): "When all the parties to the earlier treaty are parties also to the later treaty but the earlier treaty is not terminated or suspended in operation under article 59, the earlier treaty applies only to the extent that its provisions are compatible with those of the later treaty.

[576] 'Insights – Multilateral instrument: no time for BEPS fatigue*' Ernst & Young* (Tax Insights, 27 July 2017) <https://taxinsights.ey.com/archive/archive-articles/multilateral-instrument--no-time-for-beps-fatigue.aspx> ('Insights').

[577] Ibid.

[578] See, eg, Deloitte, 'Tax Essentials, Understanding the Multilateral Instrument (MLI)' (December 2019) 3

<https://www2.deloitte.com/content/dam/Deloitte/au/Documents/tax/au-tax-understanding-multilateral-instrument-december-2019-091219.pdf>.

Minimum standard MLI provisions Jurisdictions that sign the MLI are required to adopt MLI provisions forming part of the agreed minimum standards. • MLI Articles 6 and 7 reflect the minimum standard for prevention of treaty abuse under BEPS Action 6 • MLI Article 16 reflects the minimum standard for improvement of dispute resolution under BEPS Action 14 Opting out of these MLI provisions (forming part of agreed minimum standards) is possible only in limited circumstances.

[579] Ibid 3. Optional MLI provisions The MLI allows countries to opt into additional provisions in the MLI. The impact on a particular tax treaty will depend upon various opt in/opt out choices made by both countries. Optional changes to tax treaties in the MLI include changes to modify tax treaties in respect of: • Permanent establishments (PEs) • Transparent entities • Residency tiebreakers • Minimum shareholding periods • Capital gains derived from immovable property and, • Mandatory binding arbitration. For such MLI provisions, there is generally flexibility to opt out of either all or part of the provision. These choices will form a country's MLI positions.

[580] Avi-Yonah and Xu (n 116).

[581] *Multilateral Convention to Prevent BEPS* (n 322) arts 1 and 2.

[582] Avi-Yonah and Xu (n 116) 163.

opt out of non-minimum standard provisions by using a reservation.[583] There is a further provision for parties to use a reservation to opt out of the entire provisions or part thereof 'in order to preserve existing provisions that have specific, objectively defined characteristics'.[584]

6.4 Structure of the Multilateral Instrument

Professor Cooper observes:

> …it is not really a multilateral instrument in the same sense as (say) the OECD's *Convention on Mutual Administrative Assistance in Tax Matters* because its effect is to modify and amend other documents — it has no coherence as a stand-alone document because its effect is to introduce amendments into existing bilateral income tax treaties.[585]

It is generally expected that the MLI will lead to an increase in disputes, between taxpayers and tax administrations and also between countries themselves.[586] It is therefore important that the MLI also provides for an improvement of the procedure in dispute resolution treaties (the mutual agreement procedure or MAP). Although 49 pages long, the MLI does not have a detailed table of contents and comprises seven parts. Articles 3–17 contain most of the substantive rules and should be interpreted in accordance with the ordinary principle of treaty interpretation. According to this principle, a treaty shall be interpreted in good faith and by the ordinary meaning given to the terms of the treaty in their context and in light of its object and purpose (compatibility clauses in individual articles also seek to explain how the MLI provisions interact with existing treaty terms).[587]

Articles 18–26 are intended to operate as a single cohesive arbitration provision — rules for compatibility with arbitration provisions in existing agreements are consolidated in Article 26 — but parties are also permitted to formulate their own reservations with respect to the scope of cases that will be eligible for arbitration (subject to acceptance by the other parties).[588]

6.5 The Mission of the Multilateral Instrument

The mission of the MLI is described in the preamble as follows:

> [T]o ensure swift, co-ordinated and consistent implementation of the treaty-related BEPS measures in a multilateral context . . . to ensure that existing agreements for the avoidance of double taxation on income are interpreted to eliminate double taxation with respect to the taxes covered by those agreements without creating

[583] Ibid.

[584] Ibid.

[585] Cooper (n 118) 4.

[586] Ibid 5.

[587] 'Insights' (n 576).

[588] Deloitte (n 331), 2.

> opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty-shopping arrangements aimed at obtaining reliefs provided in those agreements for the indirect benefit of residents of third jurisdictions) . . . to implement agreed changes in a synchronised and efficient manner across the network of existing agreements for the avoidance of double taxation on income without the need to bilaterally renegotiate each such agreement.[589]

Therefore, the overall mission or purpose of the MLI is to implement tax treaty-related BEPS measures in a swift, coordinated, and consistent manner across the network of existing bilateral tax treaties (Covered Tax Agreements) through the instrumentality of a tax treaty, the MLI, specifically designed for that purpose without bilateral renegotiation of each agreement. Although tax treaties have played an important role in eliminating double taxation and facilitating the globalisation of liberal investment and trade since the 1920s, the frictions and mismatches in existing treaties provide loopholes that are exploited by MNEs and are one of the fundamental causes of widespread opportunities for BEPS.[590]

The MLI further reinforces the single tax principle by 'recognizing the importance of ensuring that profits are taxed where substantive economic activities generating the profits are carried out and where value is created' and clarifying the OECD's position to eliminate both double taxation and non-taxation or reduced taxation through tax evasion or avoidance.[591] Implementation of the BEPS package will demand updates to model tax conventions, including the OECD Model Tax Convention and the UN Model Tax Convention, as well as the bilateral tax treaties that follow those model conventions.[592]

To avoid uncoordinated and inconsistent unilateralism or bilateralism, pursuant to 'Action 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties', the MLI is designed to multilaterally modify individual bilateral treaties through mechanisms that provide for the individualisation of each bilateral tax treaty.

Cooper identified the following as the main provisions of the MLI: [593]

- Part II — Hybrid Mismatches (Articles 3–5)
- Part III — Treaty Abuse (Articles 6–11)
- Part IV — Avoidance of PE Status (Articles 12–14)
- Part V — Improving Dispute Resolution (Articles 16–17)
- Part VI — Arbitration (Articles 19–26).

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[589] *Multilateral Convention to Prevent BEPS* (n 322) 5.

[590] *Action Plan on Base Erosion and Profit Shifting* (n 25).

[591] *Multilateral Convention to Prevent BEPS* (n 322) preamble.

[592] 'Explanatory Statement' (n 7).

[593] Cooper (n 118) 9.

6.6 The Multilateral Instrument Vis-À-Vis the International Corporate Tax Regime

There is little doubt that the development of the MLI represents a milestone in the evolution of the international tax regime.[594] The MLI contains 39 Articles and is 48 pages in length.[595] It is supported by an Explanatory Statement, 85 pages in length.[596] But it also raises important questions about the function of tax treaties in the twenty-first century, the effectiveness of the MLI from the perspective of developing countries, and whether other steps can be taken to improve the tax treaty network beyond the MLI.[597]

Following the GFC, it was apparent that countries adversely affected needed a more efficient regime for the collection of corporate income tax and needed it quickly. The MLI is unique in international law. Cooper argues that whereas the *OECD Model Convention on Income and on Capital* is essentially 'a template serving as the basis for other operative documents', the MLI is a stand-alone document with full force and effect in international law for those countries that have signed it.[598] But is this an accurate analysis? Avi-Yonah and Xu argue that the MLI is 'not a full-fledged multilateral tax convention covering all the areas that are usually covered by bilateral tax treaties'.[599] Further, they propose that the MLI is a global consensual treaty override designed to apply the results of BEPS simultaneously to all the tax treaties where the countries involved agree. Consequently, the MLI provides an optional process for implementation by countries signing and ratifying it according to their usual constitutional norms and then depositing the ratification with the OECD.[600]

The OECD, however, holds a different view. A Legal Note on the functioning of the MLI under Public International Law provides in paragraph 11:

> The MLI is a multilateral treaty which will be applied alongside existing bilateral tax treaties modifying their application. In this way, bilateral treaties can be modified in a synchronised and consistent way *in order to swiftly implement* the tax treaty-related BEPS measures.[601]

Upon ratification, the MLI modifies the relevant provisions of the bilateral treaties of each depositing country with other depositing countries. It is not, however, a complete multilateral tax convention covering

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[594] See generally Reuven Avi-Yonah, *Advanced Introduction to International Tax Law*, (Edward Elgar Publishing, 2015) (discussing the international tax regime). For the importance of the MLI as a turning point in the evolution of the international tax regime, see Eduardo Baistrocchi (ed), *A Global Analysis of Tax Treaty Disputes* (Cambridge University Press, 2017).

[595] *Multilateral Convention to Prevent BEPS* (n 322).

[596] Ibid.

[597] See, eg, Annet Oguttu, 'Should Developing Countries Sign the OECD Multilateral Instrument to Address Treaty-Related Base Erosion and Profit Shifting Measures', (CGD Policy Paper No. 132, Center for Global Development, 13 November 2018).

[598] Cooper (n 118).

[599] Avi-Yonah and Xu (n 116) 155.

[600] Ibid.

[601] *Multilateral Convention to Prevent BEPS* (n 322).

the areas that are usually addressed in bilateral tax treaties. Cooper argues that they are both designated as 'Covered Tax Agreements' unless there is a reservation (which is not allowed in some cases involving minimum BEPS standards). If there is a question over the very nature of the MLI under International Law, then have the requirements for certainty and simplicity been overlooked?

The MLI is implemented by countries signing and ratifying it according to their usual constitutional norms and then depositing the ratification with the OECD.[602] Upon ratification by a country, the provisions of the MLI are operated to modify the relevant provisions of each depositing country's bilateral treaties that 'pair' with the bilateral treaties of other depositing countries, provided they are both designated as 'Covered Tax Agreements'. This occurs unless there is a reservation (which is not allowed in some cases involving minimum BEPS standards).[603] One of the minimum standards agreed to by all 71 signatories of the MLI is the 'principal purpose test' (PPT), which states:

> A [treaty] 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 Covered Tax Agreement.[604]

6.7 Australia and Developing Countries Vis-À-Vis the Multilateral Instrument

The MLI provides a mechanism for countries to expeditiously modify the operation of their tax treaties to implement measures designed to better address multinational tax avoidance and more effectively resolve tax disputes. These measures were developed as part of the OECD/G20 BEPS Project.[605]

Australia signed the MLI on 7 June 2017. The MLI was given the force of law in Australia by the *Treasury Laws Amendment (OECD Multilateral Instrument) Act 2018*, which received Royal Assent on 24 August 2018. Australia deposited its instrument of ratification with the OECD Depositary on 26 September 2018. The MLI entered into force for Australia on 1 January 2019. The extent to which the MLI will modify the operation of Australia's tax treaties will depend on the adoption positions taken by each jurisdiction at ratification, acceptance, or approval of the MLI.[606]

The MLI is designed to operate in conjunction with all of the individual treaties that comprise the global bilateral tax treaty network. It is unquestionably a very special treaty, in that it intervenes in existing tax

[602] Ibid.

[603] Ibid.

[604] Ibid.

[605] 'Multilateral Instrument' (n 43).

[606] Ibid.

treaties by amending their rules or adding new rules to them.[607] Although the MLI has a multilateral approach, there is a risk that its impact will differ considerably from treaty to treaty and even country to country — due to the preferences and reservations that the MLI allows, and divergent interpretations of rules. Critics of the MLI already predict numerous implementation problems.[608] Tax avoidance by MNEs has often occurred as a consequence of gaps and frictions in the interaction of the unique laws of various countries permitting tax avoidance, which is lawful, rather than as tax avoidance schemes which may fail the application of anti-avoidance provisions. One feature, inter alia, that denies the OECD claim that the MLI has treaty status is the uncertainty introduced by the PPT, a general anti-abuse regulation similar to Part IVA of Australia's *Income Tax Assessment Act 1936*.[609] The MLI leaves open how this regulation should work in practice and what abuse exactly is, with all the uncertainty for tax practice.

An important measure contained in the MLI concerns agent structures that circumvent the establishment of a taxable permanent establishment for companies. There are also measures in the MLI that affect the normal business operations of enterprises where tax planning is not paramount, in particular the strong expansion of the PE concept. There is already a risk, for example, for companies that only hold stocks or deliver goods abroad, use a foreign commercial agent, or regularly carry out small construction or installation projects.[610] The adoption of a PE often entails a lot of extra administrative burden and causes discussions between treaty partners concerning the size of the taxable profit that can be attributed to the PE. The impact of the MLI therefore extends across the full spectrum, from large multinationals to SMEs and even companies that only occasionally operate abroad.[611]

Australia's *Treasury Laws Amendment (OECD Multilateral Instrument) Act 2018* (MLI Act) received Royal Assent on 24 August 2018. The MLI Act amends the *International Tax Agreements Act 1953* to include the MLI in Section 5, which sets out current agreements that have the force of law.[612] Specifically, Section 5(1) provides that:

> Subject to this Act, on and after the date of entry into force of a provision of an agreement mentioned below, the provision has the force of law according to its tenor. This enactment empowers the MLI with the force of law to perform the functions contained in the MLI.

Pursuant to Article 34 of the MLI, the instrument enters into force as follows:

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[607] For a brief assessment of the Multilateral Instrument from the viewpoint of the Netherlands see: 'International Tax', *PFPC Global* (Web Page, 4 Feb 2019) <https://pfpcglobal.com/en/multilateral-instrument/>.

[608] Ibid.

[609] *Income Tax Assessment Act 1936* (Cth).

[610] Ibid.

[611] See, eg, Oguttu (n 597).

[612] *International Tax Agreements Act 1953* (Cth).

Article 34 – Entry into Force

1. This Convention shall enter into force on the first day of the month following the expiration of a period of three calendar months beginning on the date of deposit of the fifth instrument of ratification, acceptance, or approval.

2. For each Signatory ratifying, accepting, or approving this Convention after the deposit of the fifth instrument of ratification, acceptance or approval, the Convention shall enter into force on the first day of the month following the expiration of a period of three calendar months beginning on the date of the deposit by such Signatory of its instrument of ratification, acceptance, or approval.

David Watkins and Isabella MacInnes of Deloitte examined the BEPS Multilateral Instrument from an Australian viewpoint in *International Masterclass 2018, BEPS multilateral instrument – Now a reality:*[613]

> 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.[614]

As the MLI now has the force of an Australian law, it can operate to implement the tax treaty-related BEPS measures contained in the MLI. Consistent with that purpose, all CTAs (bilateral tax treaties to which the MLI applies) are required to meet the treaty-related minimum standards that were agreed on as part of the Final BEPS package. These are the minimum standard for the prevention of treaty abuse under Action 6 and the minimum standard for the improvement of dispute resolution under Action 14.[615]

The design of the MLI had to incorporate a significant degree of flexibility to accommodate a disparate range of countries and jurisdictions involved in developing the MLI. Regarding Australia, the MLI had to accommodate the positions of Australia and the respective countries and jurisdictions with which it has CTAs while remaining consistent with its purpose.[616] It was crucial for operational expediency that the design and functionality of the MLI provided adequate flexibility for the interaction between the various provisions of the MLI, whether or not they reflected minimum standards and particularly in relation to how

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[613] David Watkins and Isabella MacInnes (Deloitte), 'BEPS multilateral instrument – Now a reality' (International Masterclass 2018, The Tax Institute, 19 September 2018).

[614] *Multilateral Convention to Prevent BEPS* (n 322) paragraph 13.

[615] Ibid.

[616] Ibid.

such provisions interact with provisions in CTAs.[617] The Convention strives to achieve that flexibility in the following ways:

- By specifying the tax treaties to which the MLI applies (the 'Covered Tax Agreements'). Although it is intended that the Convention would apply to the maximum possible number of existing agreements, the MLI will apply only to an agreement specifically listed by the parties, that is Australian tax treaties that have been registered as CTAs by both countries that are parties to it.[618]
- Jurisdictions can choose amongst alternative provisions in certain MLI articles.[619]
- Jurisdictions can choose to apply optional provisions (for example, the provisions mandatory binding arbitration).[620]
- In certain cases, jurisdictions may choose to reserve the right not to apply MLI provisions (to opt out through a 'reservation') with respect to all of their CTAs.[621]

Now that the MLI is operational for Australia, it will be effective with respect to any particular CTA as follows:

Withholding taxes

The MLI shall have effect where the event giving rise to such taxes occurs on or after the first day of the next calendar year that begins on or after the latest of the dates on which the MLI enters into force for Australia and the relevant treaty partner jurisdiction. For example, if both treaty partners ratify the MLI before 30 September 2018, the MLI should enter into force on or before 1 January 2019, and the MLI should enter into effect in respect to a particular CTA for withholding tax purposes where the event giving rise to such taxes occurs on or after 1 January 2019.[622]

All other taxes

The MLI will apply to taxable periods beginning on or after six months after the later date of entry into force of the MLI for Australia and the treaty partner. For example, if the MLI entered into force for both countries on 1 January 2019, the MLI should apply to taxable periods starting on or after 1 July 2019.[623]

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[617] Ibid

[618] Ibid paragraph 14.

[619] 'Frequently Asked Questions on the Multilateral Instrument', *OECD* (Web Page) <http://www.oecd.org/tax/treaties/MLI-frequently-asked-questions.pdf> ('Frequently Asked Questions').

[620] Ibid.

[621] Ibid.

[622] Watkins and MacInnes (n 613).

[623] Ibid.

For countries with a tax year from 01 July to 30 June, such as Australia, the MLI applies to taxes levied for taxable periods commencing on or after 1 July 2019.

For Mutual Agreement Procedures (MAP) and mandatory binding arbitration, the MLI applies, if other criteria referred to above are met, from 1 January 2019 for MAP and arbitration purposes. As is evident from the above, the entry into effect for a particular CTA will vary from CTA to CTA as it depends upon the dates of entry into force of the MLI for both countries.[624]

Should developing countries sign the MLI? Professor Annet Oguttu believes developing countries should sign up to the MLI but should also adopt a wait-and-see approach to 'selecting and finalising options while reviewing the options selected by other countries and building capacity for implementation'.[625]

Oguttu perceives potential problems for developing countries with some processes of the MLI and is particularly concerned that many developing countries find the confidentiality of arbitral proceedings unacceptable.[626] Oguttu advances the proposition that the degree of secrecy applied to these proceedings places developing countries at a disadvantage compared to developed countries that have greater experience of the realities of the processes, which require experienced advocacy and effective management of the extraneous issues that can impact the outcome of arbitration processes.[627]

6.8 Conclusion

The MLI provides a resourceful means to expeditiously amend the global network of bilateral tax treaties without the time-consuming exercise of amending over 3,000 treaties individually. If the MLI succeeds, it can be a useful model in other areas, such as investment, where a multilateral agreement was not successful, but a growing consensus exists about the need to adjust the terms of bilateral investment treaties (BITs) to address investor responsibilities and the definition of investment comprehensively. Whether the MLI will succeed remains to be seen. On the other hand, the MLI is unlikely to prove appealing to developing countries because the failure by major economies to adopt the minimum standards in the MLI or to apply these in their treaties with developing countries would create major gaps and inconsistencies in the global tax treaty system.

Whilst the MLI provides a mechanism for the swift implementation of the OECD BEPS tax treaty measures, it adds significant complexity to cross-border transactions. Taxpayers and practitioners will need to understand which countries have signed and ratified the MLI, which agreements are CTAs, and the specific choices made by each jurisdiction in relation to the optional articles and alternative approaches. As the MLI

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[624] Ibid 26.

[625] Oguttu (n 597) Abstract.

[626] Ibid 28.

[627] Ibid.

has now entered into force in Australia, taxpayers need to assess the MLI's impact and consider whether changes to group structures, locations of people, or transactional flows would be advisable. If a particular treaty benefit is currently important, taxpayers should consider the likelihood of any potential change to that position under the MLI.

The argument that the MLI will be applied alongside existing tax treaties, rather than amending them, may prove difficult in practice. The MLI is either a tax treaty or an amending instrument; it is arguable whether it can claim the qualities of both. Logically, the end result may be a network of bilateral tax treaties, each individually drawn to operate within a dual set of legislative enactments and with the additional insertions, amendments, and procedures flowing from the MLI. As always with ground-breaking applications, difficulties with the interpretation and operation of the MLI's provisions will follow and precede legal challenges in jurisdictional courts.

For all the effort that went into the BEPS Action Plan, the resulting MLI is disappointing. The very design of the MLI with the extraordinary number of options available will create a nightmare for all but the experienced international tax professional. It is very unlikely that business managers of MNEs will understand the new system. The MLI does not address the underlying cause of BEPS — that is the bilateral tax treaty regime per se and the jurisdictional laws that have developed as a result. It is quite possible that the uncertainty and confusion the MLI will introduce may inadvertently create new gaps and frictions in the tax treaty network, which may facilitate new opportunities for BEPS.

It is arguable that the MLI may eventually operate as a bridge between the current bilateral tax treaty regime and a future MTT. Many academic papers have dealt with the recognition by the academic world and practice that an MTT is increasingly needed.[628] There are three reasons why an MTT makes more sense than a network of bilateral tax treaties. First, the rise of GATT, and then the WTO after World War II, has demonstrated that a multilateral treaty governing important areas of international economic/taxation law is feasible if sufficient flexibility is included for reservations (i.e., allowing countries to opt out of specific provisions). Second, there has been increasing convergence in the language of the OECD and UN model tax treaties, which have become increasingly analogous over time.[629] Third, with the pre-COVID19 expansion of globalisation, tax competition treaty shopping employing the use of bilateral tax treaties to obtain advantages for non-treaty country residents has increased.[630]

[628] See, eg, Brooks (n 121); Kim (n 121); Reinhold (n 121); Rixen (n 121); Thuronyi (n 47); Vann (n 4).

[629] Reuven Avi-Yonah, Nicola Sartori & Omri Marian, *Global Perspectives on Income Taxation Law* (Oxford University Press, 2011) 150.

[630] Reuven Avi-Yonah and C. H. Panayi, 'Rethinking Treaty Shopping: Lessons for the European Union' in Michael Lang et al (eds), *Tax Treaties: Building Bridges Between Law and Economics* (IBFD, 2010) 21.

Another method that utilises circumstances in which tax avoidance results is applied when treaty residents do business in third countries in ways that affect the treaty but are not covered by it. This has become far more common.[631]

One of the impediments to an MTT has always been that investment flows vary by each pair of countries; therefore, appropriate withholding tax rates vary as well.[632] That is the main reason for the remaining differences between the OECD and UN models because flows between developed countries are more reciprocal than flows between developed and developing countries. But that is also changing, as more developing countries become capital exporters as well as importers.[633] Furthermore, several authors have recognised for some time that it may be possible to negotiate a multilateral treaty but leave the withholding tax rates to be settled by bilateral negotiation, as the UN model does.[634]

The following chapter analyses the multilateral instrument.

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[631] Emily Fett, *Triangular Cases: The Application of Bilateral Income Tax Treaties in Multilateral Situations* (IBFD, 2014).

[632] Deloitte, 'Withholding Tax Rates 2017' (March 2017) <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-withholding-tax-rates.pdf>.

[633] For an overview of the general trends of participation of developing countries in world trade, see Committee on Trade and Development, 'Participation of Developing Countries in World Trade: Overview of Major Trends and Underlying Factors' (WTO Doc. WT/COMTD/W/15, 16 August 1996).

[634] Eran Lempert, 'Crossing the Barrier: Towards a Multilateral Tax Treaty' (unpublished J.S.D. dissertation, New York University, 2009).

CHAPTER 7: AN ANALYSIS OF THE MULTILATERAL INSTRUMENT

7.1 Introduction

The Multilateral Convention was developed by the OECD pursuant to Action 15 of the Action Plan on BEPS.[635] The MLI and accompanying Explanatory Statement were adopted by the OECD on 24 November 2016.[636]

The OECD appears to have strong reasons to avoid the adoption of a multilateral treaty at all costs. During the past nine years, the OECD has published a vast number of reports on BEPS that are highly repetitious regarding the alleged loss of revenue through BEPS. The OECD presents the MLI as a flexible methodology designed to enable an expeditious amendment of the thousands of bilateral tax treaties that comprise the preponderance of the global taxation treaty network by operation of a single instrument rather than arduously amending treaty by treaty.[637] However, it is arguable that the sheer complexity of the MLI in operation, compounded by the uncertainty that will result, will make the amendment of the bilateral treaties relatively ineffective in reducing BEPS.

7.2 Public International Law

A treaty is a formal, legally binding, written agreement between parties in international law. Treaties are usually entered into by sovereign states and international organisations but can sometimes include individuals, business entities, and other legal persons.[638] A treaty may also be known as an international agreement, protocol, covenant, convention, pact, or exchange of letters, among other terms. Regardless of

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[635] *Action Plan on Base Erosion and Profit Shifting* (n 25).

OECD, Action 15 "Develop a multilateral instrument. Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution."

[636] 'Explanatory Statement' (n 7).

[637] *Multilateral Convention to Prevent BEPS* (n 322).

'The MLI offers concrete solutions for governments to close the gaps in existing international tax rules by transposing results from the OECD/G20 BEPS Project into bilateral tax treaties worldwide. The MLI modifies the application of thousands of bilateral tax treaties concluded to eliminate double taxation. It also implements agreed minimum standards to counter treaty abuse and to improve dispute resolution mechanisms while providing flexibility to accommodate specific tax treaty policies.'

[638] Malcolm Shaw, 'Treaty' in *Encyclopaedia Britannica* (online) < https://www.britannica.com/topic/treaty>.

'Treaty, a binding formal agreement, contract, or other written instrument that establishes obligations between two or more subjects of international law (primarily states and international organizations). The rules concerning treaties between states are contained in the *Vienna Convention on the Law of Treaties* (1969), and those between states and international organizations appear in the *Vienna Convention on the Law of Treaties Between States and International Organizations or Between International Organizations* (1986)'. See also, Anders Henriksen, 'The actors in the international legal system' in Anders Henriksen, *International Law* (Oxford University Press, 2019).

terminology, only instruments that are legally binding upon the parties are considered treaties under, and governed by, international law.[639]

Treaties are similar to contracts, in that they establish the rights, obligations, and binding commitments of the parties.[640] They can encompass significant divergence in form, substance, and complexity, and may regulate a multiplicity of issues, for example, territorial boundaries, taxation trade and commerce, and mutual defence. Treaties that create international entities can also provide a constitution thereof, as with, for example, the *Rome Statute of the International Criminal Court* and the *Charter of the United Nations*.[641]

Treaties are among the earliest enactments of jurisdictional relationships, with the earliest known example being the Egyptian – Hittite peace treaty, commonly called the Eternal or Silver Treaty, which dates back to the mid-13th century BC.[642] Today, treaties are recognised as a primary source of international law.[643] The international law on treaties has mostly been codified by the *Vienna Convention on the Law of Treaties* (Vienna Convention), which sets forth the rules and procedures for creating, amending, and interpreting treaties, as well as for resolving disputes and alleged breaches.[644]

The Vienna Convention is an international agreement regulating treaties between countries and organisations.[645] Known as the 'treaty on treaties', it created comprehensive rules, procedures, and guidelines for how treaties are defined, drafted, amended, interpreted, executed, and generally operated.[646] It is regarded as one of the most important instruments in treaty law and remains an authoritative guide in disputes over treaty interpretation.[647]

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[639] In the United States constitutional law, the term 'treaty' has a special meaning which is more restricted than its meaning in international law; see United States law below.

[640] Bryan Druzin ' Opening the Machinery of Private Order: Public International Law as a Form of Private Ordering' (2014) 58 S*aint Louis University Law Journal* 452–456.

[641] *Charter of the United Nations*.

[642] The Egyptian-Hittite peace treaty between Ramesses II of Egypt and Ḫattušili III of the Hittite invaders based in Mesopotamia, was signed in the mid-13th century BCE, and is held on exhibit in the Neues Museum, Berlin, Germany.

[643] Oliver Dörr and Kirsten Schmalenbach, 'Introduction: On the Role of Treaties in the Development of International Law' in Oliver Dörr and Kirsten Schmalenbach, *Vienna Convention on the Law of Treaties: A Commentary* (Springer Berlin Heidelberg, 2012) 1–6.

[644] Oxford University Press, *Max Planck Encyclopaedias of Public International Law,* (article last updated February 2021), 'Treaties'.

[645] Patricia Bauer, 'Vienna Convention on the Law of Treaties' in *Encyclopaedia Britannica* (online) < https://www.britannica.com/topic/Vienna-Convention-on-the-Law-of-Treaties>.

[646] Oxford University Press, *Max Planck Encyclopedias of International Law* (article last updated June 2006), 'Vienna Convention on the Law of Treaties (1969)'.

[647] '50 Years Vienna Convention on the Law of Treaties' *Universitaet Wien* (Web Page, 18 November 2019), <https://deicl.univie.ac.at/en/news-international-law/detail-view/news/50-years-vienna-convention-on-the-law-of-treaties-1/?tx_news_pi1%5Bcontroller%5D=News&tx_news_pi1%5Baction%5D=detail&cHash=c453697a2b62c1a403b06e4408c12119>.

Most treaties have internal procedures and mechanisms governing potential disagreements. International treaties can be divided into bilateral treaties and multilateral treaties. The former are concluded between two countries or entities.[648] A multilateral treaty is concluded among several countries, establishing rights and obligations between each party and every other party.[649] Multilateral treaties may be regional or involve many countries across the world.[650]

The principles governing the amendment and modification of treaties are contained in Part IV of the Vienna Convention, with Article 40 containing the rules relating to the amendment of multilateral treaties. An assessment of the MLI pursuant to the comprehensive rules, procedures, and guidelines that determine how treaties are defined, drafted, amended, interpreted, executed, and generally operated, as set forth in the Vienna Convention, provides grounds on which the MLI can arguably be classified as an MTT.[651] A more in-depth analysis of the status of the MLI under international law is extraneous to this study.

Globalisation and the increasing role of the internet in facilitating revolutionary commercial activities and providing the technology to sell products in circumstances that would formerly have required a degree of physical presence appeared to challenge the application of tax concepts developed for a physical rather than a virtual world.[652] In 2017, Pinto provided an in-depth critical analysis of the tax-related challenges raised by

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[648] Harold Nicolson, *Diplomacy* (Institute for the Study of Diplomacy, 1934) 135.

[649] See, eg, Georgetown Law Library, *Multilateral Tax Treaties, Multilateral Tax Treaties - International and Foreign Tax Law Research Guide - Guides at Georgetown Law Library* <https://guides.ll.georgetown.edu/c.php?g=363487&p=4817002>. *Convention on Mutual Administrative Assistance in Tax Matters* (1988).
'This treaty is the most comprehensive multilateral instrument facilitating inter-state co-operation to combat tax evasion and avoidance. It was drafted as a joint initiative of the Organisation for Economic Cooperation and Development (OECD) and the Council of Europe'.

Protocol Amending the Convention on Mutual Assistance in Tax Matters (2010). This protocol to the 1988 convention provides for the exchange of information, multilateral simultaneous tax examinations, the service of documents, and cross-border assistance in tax collection, among other matters.

[650] See, eg, United Nations, *Convention on the Prohibition of Military or any other Hostile Use of Environmental Modification Techniques* (10 December 1976) <https://treaties.un.org/doc/source/titles/english.pdf>.

[651] See, eg, 'Explanatory Statement' (n 7); Cooper (n 118), 4; David Kleist (n 120) 31; 'Multilateral Instrument' (n 43). Contra, Avi-Yonah and Xu (n 116).

'The new OECD MLI represents the culmination of this line of thinking. It is not a full-fledged multilateral tax convention covering all the areas that are usually covered by bilateral tax treaties. Instead, it is a global consensual treaty override designed to apply the results of base Erosion and Profit Shifting (BEPS) simultaneously to all the tax treaties where the countries involved agree.'

[652] OECD, *Implementation of the Ottawa Taxation Framework Conditions*: *The 2003 Report* (2002), 11 <https://www.oecd.org/tax/administration/20499630.pdf>.

'The Ottawa OECD Ministerial Conference in 1998 "A Borderless World – Realising the Potential of Electronic Commerce", which brought together OECD and non-OECD governments and the business community, furthered this through the adoption of the Ottawa Taxation Framework Conditions, which included a set of broad taxation principles that should apply to e-commerce (see Box 1).

Box 1: Ottawa Taxation Framework Conditions – Principles

the digital economy. He applied the Ottawa Principles to critically analyse the key features of the digital economy from a tax perspective.[653] Pinto used a similar methodology in 2002 when analysing the continuing role of source-based taxation in an electronic commerce environment. [654] This thesis has adopted Pinto's methodology to briefly analyse the operation of the MLI and the effect of its application on the global bilateral tax treaty regime.

An assessment of the effectiveness of the MLI provisions and the MLI's compliance with the Ottawa Principles of neutrality, efficiency, complexity, effectiveness, and flexibility will now be undertaken.

7.3 Taxation Law - Applying the Ottawa Principles to the Multilateral Instrument

The traditional prerequisites for sound tax policy include neutrality, efficiency, certainty and simplicity, effectiveness, and flexibility. These overarching principles were the basis for the 1998 Ottawa Ministerial Conference and are since then referred to as the Ottawa Taxation Framework Conditions.[655] It is noteworthy that the *OECD Model Tax Convention on Income and on Capital*[656] contains 28 Articles and is 18 pages long. The MLI that is intended to amend the network of treaties based on the OECD Model contains 39 Articles and is 48 pages in length.[657] It is supported by an Explanatory Statement, 85 pages in length. It is

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Neutrality

i) Taxation should seek to be neutral and equitable between forms of electronic commerce and between conventional and electronic forms of commerce. Business decisions should be motivated by economic rather than tax considerations. Taxpayers in similar situations carrying out similar transactions should be subject to similar levels of taxation.

Efficiency

ii) Compliance costs for taxpayers and administrative costs for the tax authorities should be minimised as far as possible.

Certainty and simplicity

iii) The tax rules should be clear and simple to understand so that taxpayers can anticipate the tax consequences in advance of a transaction, including knowing when, where and how the tax is to be accounted.

Effectiveness and fairness

iv) Taxation should produce the right amount of tax at the right time. The potential for tax evasion and avoidance should be minimised while keeping counter-acting measures proportionate to the risks involved.

Flexibility

v) The systems for taxation should be flexible and dynamic to ensure that they keep pace with technological and commercial developments.'

[653] Pinto, 'A Preliminary Analysis' (n 75) 7.

[654] Pinto, 'The Continued Application of Source-Based Taxation' (n 74).

[655] 'Addressing the Tax Challenges of the Digital Economy' (n 311).

[656] OECD, *Model Tax Convention on Income and on Capital 2017 (Full Version)*, 2017, OECD Publishing < https://www.oecd.org/tax/model-tax-convention-on-income-and-on-capital-full-version-9a5b369e-en.htm> ('*Model Tax Convention 2017*').

[657] *Multilateral Convention to Prevent BEPS* (n 322).

submitted that these facts alone raise a presumption of the MLI's non-compliance with the principles of certainty, simplicity, and effectiveness, which will be examined later in this chapter.

7.3.1 Neutrality

From the perspective of taxation neutrality, arguably the most philosophical division within the encompassment of the global taxation regime is the comparison of corporate tax collection between developed and developing countries. In 2018, Professor Annet Wanyana Oguttu of the University of Pretoria, South Africa examined the question of the MLI's neutrality and argued that:

- the failure by major economies to adopt the minimum standards in the MLI or to apply these in their treaties with developing countries would create major gaps and inconsistencies in the tax treaty system;[658] and
- according to the OECD, the root cause of BEPS is the existence of 'gaps and inconsistencies' in the bilateral tax treaty system.[659]

Oguttu is generally critical of the MLI and observes:

> General criticisms and concerns about the MLI and the BEPS project are that developing countries (beyond the major emerging economies in the G20) had little or no involvement in its development and that it does not reform the underlying source-residence split in international tax rules. There are also practical questions about whether the MLI will be effective since many countries have opted out of certain provisions. The sheer complexity of the MLI and the various uncertainties regarding the practical application and interpretation of the MLI are also major concerns for developing countries. Nevertheless, the MLI is potentially a useful mechanism for developing countries to tackle 'treaty shopping' and other treaty-related profit shifting.

When considering the question of whether developing countries should sign the MLI, Oguttu observed that there were several good reasons for developing countries to sign the MLI:

- The tax treaty-related BEPS measures set out in the MLI have the potential to reduce vulnerability to tax planning strategies that exploit gaps and mismatches in tax rules to artificially shift profits to low- or no-tax locations where there is little or no corresponding economic activity.

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[658] Oguttu (n 597).

[659] See, eg, *Addressing Base Erosion and Profit Shifting* (n 23). While multinational corporations urge co-operation in the development of international standards to alleviate double taxation resulting from differences in domestic tax rules, they often exploit differences in domestic tax rules and international standards that provide opportunities to eliminate or significantly reduce taxation. *Addressing Base Erosion and Profit Shifting: Executive Summary* (above n 23) 5. See also *Action Plan on Base Erosion and Profit Shifting* (n 25), Chapter 2, Background, 9: 'When designing their domestic tax rules, sovereign states may not sufficiently take into account the effect of other countries' rules. The interaction of independent sets of rules enforced by sovereign countries creates frictions, including potential double taxation for corporations operating in several countries. It also creates gaps, in cases where corporate income is not taxed at all, either by the country of source or the country of residence or is only taxed at nominal rates. In the domestic context, coherence is usually achieved through a principle of matching – a payment that is deductible by the payer is generally taxable in the hands of the recipient, unless explicitly exempted. There is no similar principle of coherence at the international level, which leaves plenty of room for arbitrage by taxpayers, though sovereign states have co-operated to ensure coherence in a narrow field, namely, to prevent double taxation.'

- The MLI is designed so that it can modify any DTA, whether based on the OECD or the UN Model Conventions.
- The MLI can strengthen source taxation, especially by addressing treaty shopping, and abuse of the taxable presence requirement in the definition of a permanent establishment.
- The provisions can preserve source taxation by ensuring that profits are taxed where the economic activities generating those profits are performed and where value is created.
- Considering the costs and time involved in re-negotiating treaties, the MLI provides the easiest and less costly method of updating treaties. Reliance on bilateral negotiations to introduce the BEPS measures would cause uncertainties, delays and expenses and would tend to disadvantage developing countries.[660]

Professor Reuven Avi-Yonah and Professor Haiyan Xu examined the MLI in 2018 in the peer-reviewed journal article 'A Global Treaty Override? The New OECD Multilateral Tax Instrument and its Limits'.[661] Their view is that:

- The whole point of the BEPS project and the MLI is to enforce the single tax principle by ensuring that source taxation will apply in situations where there is no residence taxation because of tax arbitrage or the use of pass-through entities. And that is why in the absence of the MLI, treaties could become useless, but with the MLI, they are still quite useful.
- There does not appear to be a significant body of academic opinion supporting the view that the MLI offends the test of neutrality.

In summary, research conducted failed to establish that there is a significant volume of academic opinion supporting the view that the MLI fails the neutrality test.

7.3.2 Efficiency and Effectiveness

The term 'efficiency' is defined by dictionary.com as:

- the state or quality of being efficient, or able to accomplish something with the least waste of time and effort;
- accomplishment of or ability to accomplish a job with a minimum expenditure of time and effort.[662]

Whilst the MLI is an innovative document for its primary purpose that is to provide a quick method of amending a multitude of bilateral tax treaties[663] does it meet the Ottawa Principles requirement of 'efficiency'? Graeme Cooper examined the MLI in 2019 and made the following comments regarding the MLI:

While it is a multilateral instrument, its effect is to amend many of Australia's bilateral tax treaties which makes the MLI probably the most complicated and annoying amending document ever created. It is complicated because the

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[660] Oguttu (n 597) 4.

[661] Avi-Yonah and Xu (n 116).

[662] Dictionary.com, https://www.dictionary.com/browse/efficiency.

[663] *Multilateral Convention to Prevent BEPS* (n 322).

mechanisms used to amend the text are prolix and very imprecise. Sometimes existing text is exercised and replaced by a new test; sometimes existing text and new text will have to be read together and their inconsistencies reconciled. And it is annoying because, for the most part, the changes being made by the MLI are trivial, often to the point of total irrelevance.

The MLI provides multiple options for signing jurisdictions, including options for tax jurisdictions, to reject entire provisions of the MLI. The impact of such a rejection is amplified by the ensuing consequence that the rejected provisions will not apply to that CTA where one of the parties to the CTA has made reservations against a provision of the MLI.[664] There are some mandatory provisions within the MLI, but they are few in number.[665] Accordingly, signing the MLI does not lock tax jurisdictions into a commitment to abide by all, or even most, of the MLI's provisions.[666]

Incongruously, many of the MLI's strictest and otherwise most impactful provisions are either optional or can be opted out of by signing jurisdictions. The entirety of Part II of the MLI, addressing what the OECD calls 'hybrid mismatches', is optional for signing parties.[667] The mere signing of the MLI does not necessarily bind a tax jurisdiction to classify transparent entity income as that of a resident, take measures to prevent double non-taxation, or do anything to address Action Two of the BEPS Project.[668]

Whilst the MLI may theoretically provide an efficient method of amending the bilateral tax treaties, it performs this function in a very inefficient manner as it introduces considerable confusion, complexity, and uncertainty, as outlined. In summary, there is considerable academic support for the view that the MLI fails to provide an efficient method of advancing the opposition to BEPS. It is submitted that the complexity and uncertainty of the MLI and the voluminous material presented as explanatory material may lead to more opportunities for BEPS.

For example, pursuant to Section 284–75(2) of Schedule 1 to the *Taxation Administration Act 1953* (Cth), a taxpayer is liable to an administrative penalty if, in a statement to the Commissioner, the taxpayer has treated an income tax law as applying to a matter in a particular way that was not 'reasonably arguable'.[669] The expression 'reasonably arguable' formerly appeared in s 226K of the *Income Tax Assessment Act 1936* (Cth). In a 2003 case, *Walstern v FCT*, Hill J expounded a number of propositions about the correct approach to penalty under the former s 226.[670] If a taxpayer has an arguable position on an issue (a

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[664] Jack Bernstein, 'It Takes Two to Tango' (2017) 88 *Tax Notes International* 1073.

[665] *Multilateral Convention to Prevent BEPS* (n 322) art 19(4).

[666] Ibid.

[667] Ibid arts 3–5.

[668] Ibid.

[669] *Taxation Administration Act 1953* (Cth).

[670] *Walstern Pty Ltd v FC of T*, Federal Court of Australia, 08 December 2003.

contentious issue), then penalties are not applied. Those principles have been applied in a number of decisions of the Full Court of the Federal Court without reservation, until recently. The complicated construction and operation of the MLI may itself provide opportunities for the 'arguable position' defence to the imposition of penalties by the ATO.

7.3.3 Complexity and Certainty

Terms such as 'tax complexity' are open to various definitions, including the manner in which taxpayers perform tax compliance activities.[671] In *Untangling the Income Tax*, David Bradford characterises three types of tax complexity:

- compliance complexity, which refers to the problems faced by the taxpayer in tasks such as keeping records, choosing forms, and making necessary calculations;
- transactional complexity, which refers to the problems faced by taxpayers in organising their affairs within the framework of the rules; and
- rule complexity, which refers to the problems of interpreting written and unwritten rules.[672]

Although the first two components relate to the taxpayer's compliance activities, the last type of complexity relates specifically to the relevant taxation rules. The current global taxation regime was developed by the League of Nations in the 1920s, mainly to avoid double taxation, and the first model was published in 1928. The current global tax system is comprised mainly of the following:

- thousands of bilateral tax treaties that vary significantly from each other and are based on either the OECD or UN models;
- the Full Version of the OECD *Model Tax Convention on Income and on Capital,* 2624 pages in length and first published in the 1920s;[673]
- the United Nations Model Tax Treaty, developed primarily for developing jurisdictions and published in draft form in 1963, currently 804 pages in length;[674]
- several geographically localised multilateral tax treaties.

The *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent BEPS* was signed by over 100 jurisdictions in November 2016 and consists of the following documents:

- MLI (48 pages)[675]

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[671] Frank Pedersen, 'Advancing the Study of Tax Complexity with the Usability Model' (2012) XII (2) *Houston Business and Tax Law Journal* 282–361.

[672] David Bradford, *Untangling the Income Tax* (Harvard University Press, 1986).

[673] *Model Tax Convention 2017* (n 656).

[674] United Nations, *Model Double Taxation Convention between Developed and Developing Countries* (2017) <https://www.un.org/esa/ffd/wp-content/uploads/2018/05/MDT_2017.pdf>.

[675] *Multilateral Convention to Prevent BEPS* (n 322).

- Explanatory Statement (85 pages).[676]

There are currently 195 jurisdictions globally, which each have their own unique tax laws resulting from the bilateral model tax treaty coupled with tax sovereignty.[677] This is arguably a highly complex tax regime, which will now have to adjust to the uncertainty created by the predominant optional character of many of the MLI amendments.

The MLI coverage is far-reaching, cumbersome, and technical in nature. It also interacts with existing tax treaties in a convoluted way, as emphasised by the fact that an 85-page Explanatory Statement was considered necessary to clarify the MLI's methodology and its application to amend existing bilateral tax treaties.[678] Some MLI provisions are remarkably complicated, such as the ostensibly simplified limitation on benefits (LOB) provision in Article 8, which stretches over four pages. The complexity of the MLI follows partly from the fact that it is a flexible instrument that allows for an almost infinite number of combinations of reservations and options. Moreover, the MLI introduces a subjective element in tax treaties that did not previously exist (other than as a guiding principle in the commentary to the OECD Model Tax Convention).[679]

In particular, the MLI introduces an anti-abuse provision in the form of the principal purpose test (PPT) provision in Article 7 of the MLI and, since the 2017 update, in Article 29(9) of the OECD Model Tax Convention.[680] Article 7 provides that treaty benefits shall be denied 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.[681]

Joseph Morley examined the operation and effectiveness of the MLI and predicted that the MLI will have a limited direct impact on BEPS.[682] The subjective nature of this provision makes it virtually impossible to make a reasonably certain prediction on whether treaty benefits will be denied in a given situation. This creates uncertainty, is quite complex, and arguably creates legal uncertainty. To obtain a clearer picture of whether the MLI will in fact lead to an increase in rule complexity and legal uncertainty, one must first

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[676] 'Explanatory Statement' (n 7).

[677] See for example, Tom Maguire**,** 'The EU Is Asking Questions About Tax Sovereignty - But the Clue Is in the Title', *Deloitte* (Web Page, 13 January 2019) <https://www2.deloitte.com/ie/en/pages/tax/articles/the-EU-is-asking-questions-about-tax-sovereignty.html>.

[678] 'Explanatory Statement' (n 7).

[679] Ibid.

[680] *Model Tax Convention 2017* (n 656) art 7.

[681] Ibid.

[682] Morley (n 117).

estimate the impact of the MLI on existing tax treaties. Parties to the MLI can make reservations against provisions of the MLI that do not reflect minimum standards. Where a jurisdiction has made a reservation against an article, that article will generally not apply to any of its CTAs. Parties to the MLI may also exclude some of their tax treaties from the scope of the MLI. Moreover, some states have not signed the MLI, which, of course, means that their tax treaties will remain unaffected by it.[683]

Professor Kleist examined the content and operation of the MLI by applying Bradford's 'Rule Complexity' test,[684] and made the following observation:

> Some rules provided in the MLI are particularly complicated, including the so-called simplified limitation on benefits provision in Article 8, which stretches over four pages. And the complexity of the MLI is also enhanced by the fact that it is a flexible instrument that allows for an almost infinite number of combinations of reservations and options. Insofar as parties to the MLI will use such reservations and options, their implementation of the MLI will rarely be identical. Reading and understanding the MLI is no easy task, even for a lawyer working full time with international tax matters. For the layperson, the MLI may be perceived as impenetrable.

It can be argued that one of the strengths of tax treaties is their reliance on objective criteria and their ability to create some degree of certainty in a complex and uncertain international tax environment. This very important characteristic of tax treaties will be lost to some extent with the introduction of the PPT rule, which introduces into tax treaties a subjective element that did not previously exist. There is an inherent danger with the ongoing application of the MLI that an increasing number of parties involved in the taxation area will find it progressively more difficult to remain conversant with the tax laws that govern their business operations.[685]

7.3.4 Flexibility

The designers of the MLI were conscious of the need to ensure broad participation, so it was decided to make the MLI flexible enough to accommodate the disparities of a wide cross-section of tax jurisdictions.[686]

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683 Ibid.

684 Bradford (n 672).

685 Ibid. 'Even under the articles that carry mandatory requirements, the requirements are relatively minimal. Under Article 6, signing jurisdictions must only commit to including in their CTAs a preamble indicating their desire to eliminate double-taxation and double non-taxation. Article 7 only mandates the application of the principal purpose test. Article 7 leaves the Simplified Limitation on Benefits Provision, which makes it more difficult for businesses to receive treaty benefits, optional. Article 9 also permits signing jurisdictions to refrain from applying paragraph (1), which provides for the taxing of gain on the alienation of interests an entity holds in another entity that derive a certain amount of their value from real property in another contracting jurisdiction. As of the date of this writing, forty-three of the signing jurisdictions have indicated that they do not intend to fully apply Article 8; at least forty-six have indicated that they do not intend to fully apply Article 9; fifty-seven have indicated that they do not intend to fully apply Article 10; and fifty-five have indicated that they do not intend to fully apply the provisions of Article 11 to their CTAs.'

686 See, eg, 'Explanatory Statement' (n 7) paragraph 14:

The MLI also needed to provide flexibility in relation to provisions in existing tax treaties that differ for various reasons.[687] Flexibility is accomplished in the MLI through the employment of a number of devices, including a mechanism that follows from Articles 1 and 2 of the MLI. According to Article 1, the MLI modifies 'all Covered Tax Agreements as defined in subparagraph a) of paragraph 1 of Article 2 (Interpretation of Terms)'.[688]

Article 2 defines a CTA as a double tax treaty with respect to which each party to the tax treaty has made a notification to the Depositary administered by the OECD. [7] This means that a party can decide to exclude a tax treaty that it has entered into from the MLI's scope of application simply by choosing not to notify it to the Depositary. According to the OECD, more than 85% of the tax treaties concluded among the MLI signatories are already covered by the MLI, and more treaties are likely to be notified when the signatories have finalised their discussions on coordination of their respective choices relating to the contents of the MLI.[689]

The MLI is an operative document that enables the amendment of bilateral tax treaties. Whereas the MLI is not demonstratively uncertain upon examination of its provisions, it may be when examined from the viewpoint of the bilateral tax treaties it amends. The OECD declared that the MLI is intended to be 'flexible', and this aim appears to have been achieved,[690] or over-achieved according to several academic papers.[691]

Joseph Morley further commented:

> The MLI provisions dealing with the prevention of treaty abuse require only slightly more action from signing jurisdictions. Specifically, all but Article 6, Article 7, and Article 9 within Part III of the MLI are completely optional. Thus, the measures limiting the tax exemption of international dividends, the provisions limiting the

'As noted above, the purpose of the Convention is to swiftly implement the tax treaty-related BEPS measures. Consistent with that purpose, the ad hoc Group considered that the Convention should enable all Parties to meet the treaty-related minimum standards that were agreed as part of the Final BEPS package, which are the minimum standard for the prevention of treaty abuse under Action 6 and the minimum standard for the improvement of dispute resolution under Action 14. Given, however, that each of those minimum standards can be satisfied in multiple different ways and given the broad range of countries and jurisdictions involved in developing the Convention, the Convention needed to be flexible enough to accommodate the positions of different countries and jurisdictions while remaining consistent with its purpose. The Convention also needed to provide flexibility in relation to provisions that did not reflect minimum standards, particularly in relation to how such provisions interact with provisions in Covered Tax Agreements.'

[687] Ibid paragraph 14.

[688] OECD (n 318).

[689] Ibid.

[690] *Frequently Asked Questions* (n 619).

[691] See, eg, Morley (n 117); Cooper (n 118).

> ability of entities to avoid tax by conducting business through entities in third jurisdictions, and the provisions limiting the exceptions to a tax jurisdiction's ability to tax its own residents are entirely optional.[692]

Morley also commented that:

> Of the ninety-five tax jurisdictions that have signed the MLI as of 18 February 2021, fifty-nine have stated that they do not intend to apply Article 3 completely, fifty-six have stated that they will not apply Article 4 completely, and forty-three have stated that they do not intend to apply one of the options in Article 5 to their CTAs.[693]

7.4 Judging the Multilateral Instrument

Cooper assessed the MLI as 'complicated'[694] and further observed: '… and it is annoying because, for the most part, the changes being made by the MLI are trivial, often to the point of total irrelevance'.[695]

Cooper continues with the following observation:

> Unlike the OECD's *Model Convention on Income and on Capital*[696] it is not merely a template serving as the basis for other operative documents; it is a document with full force and effect in international law for those countries that have signed it.[697]

While it would be difficult to argue that the MLI is not flexible or neutral, it would be equally difficult to argue that the MLI is efficient, certain, or simple. The decision by the OECD to override the Ottawa Taxation Framework Conditions, for what is arguably a highly experimental process with no substantial foundation in taxation law, risks providing further opportunities for tax avoidance by MNEs.

Joseph Morley suggests the MLI will have a limited direct impact on BEPS. He predicts that notwithstanding the efforts to resolve many of the BEPS Project's concerns, the MLI does not provide final solutions to the BEPS Actions and will ultimately be largely ineffective at reducing BEPS.[698] As the MLI

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[692] Morley (n 117) 243.

[693] *Signatories and Parties to the Multilateral Convention* (n 42).

Number of signatories:	95
Intend to sign:	4
Deposit of instrument of Ratification, Acceptance or Approval:	63
Notifications pursuant to Article 35(7)(b) of the MLI:	3
Notifications made after becoming a party:	3

[694] Cooper (n 118) 4.

[695] Ibid.

[696] *Model Tax Convention 2017* (n 656).

[697] Cooper (n 118) 4.

[698] Morley (n 117).

itself indicates, it is 'flexible'.[699] While in some cases this means that the MLI provides multiple options for signing jurisdictions, in many cases, this provides tax jurisdictions with the opportunity to reject entire provisions of the MLI. The impact of a tax jurisdiction's rejection of an MLI provision is magnified by the fact that where one of the CTA parties has made reservations against an MLI provision, the provision will not apply to that CTA.[700]

Although there are some mandatory provisions within the MLI, they are relatively few in number.[701] Accordingly, signing the MLI does not, in and of itself, mean that tax jurisdictions are committing to abide by all, or even most, of the MLI's provisions. Indeed, many of the MLI's strictest and otherwise most impactful provisions are either optional or can be opted out of by signing jurisdictions. The entirety of Part II of the MLI, addressing what the OECD calls 'hybrid mismatches', is optional for signing parties.[702]

The signing of the MLI does not bind a tax jurisdiction to classify transparent entity income as that of a resident or prevent double non-taxation.[703] A substantial number of tax jurisdictions have indicated they neither intend to apply Articles 3 and 4 in their entirety nor intend to apply one of the options in Article 5 to their CTAs.[704]

The MLI provisions dealing with the prevention of treaty abuse, all but Article 6, Article 7, and Article 9 within Part III of the MLI, are completely optional.[705] Thus, the measures limiting the tax exemption of international dividends,[706] the provisions limiting the ability of entities to avoid tax by conducting business through entities in third jurisdictions,[707] and the provisions limiting the exceptions to a tax jurisdiction's ability to tax its own residents are entirely optional.[708] Even under the articles that carry mandatory requirements, the requirements are relatively minimal. Under Article 6, signing jurisdictions must only commit to including in their CTAs a preamble indicating their desire to eliminate double taxation and double

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[699] *Frequently Asked Questions* (n 619).

[700] Bernstein (n 664).

[701] *Multilateral Convention to Prevent BEPS* (n 322).

[702] Ibid arts 3–5.

[703] Ibid.

[704] *Signatories and Parties to the Multilateral Convention* (n 42). For the purposes of these numbers, tax jurisdictions that do not intend to apply a particular MLI provision because they believe comparable substance is already reflected in their treaties are considered to intend to apply the MLI provision. The accuracy of this assumption obviously depends on the accuracy of the language of individual tax treaties.

[705] *Multilateral Convention to Prevent BEPS* (n 322) art 6, art 7 and art 9.

[706] Ibid art 8.

[707] Ibid art 10.

[708] Ibid art 11.

non-taxation. Article 7 only mandates the application of the PPT. Article 7 makes the Simplified Limitation on Benefits Provision optional, which makes it more difficult for businesses to receive treaty benefits.[709]

Article 9 also permits signing jurisdictions to refrain from applying paragraph (1), which provides for the taxing of gain on the alienation of interests that an entity holds in another entity and that derive a certain amount of their value from real property in another contracting jurisdiction.[710] As of the date of this writing, forty-three of the signing jurisdictions have indicated that they do not intend to fully apply Article 8; at least forty-six have indicated that they do not intend to fully apply Article 9; fifty-seven have indicated that they do not intend to fully apply Article 10; and fifty-five have indicated that they do not intend to fully apply the provisions of Article 11 to their CTAs.[711] In addition, the entirety of Part IV of the MLI is optional for signing jurisdictions.[712]

These articles, which target the ability of businesses to avoid PE status through 'artificial' tax manoeuvres, are thus not inherently binding on signing jurisdictions.[713] At the time of this writing:

1. forty-three signing jurisdictions have expressed their intent not to apply the provisions of Article 12
2. thirty have expressed their intent not to apply the provisions of Article 13
3. fifty-seven have expressed their intent not to fully apply Article 14 and
4. thirty-four have expressed their intent not to fully apply the Article 15 definitions to their CTAs.[714]

Additionally, many of the efforts to improve dispute resolution measures are optional. The entire provision for binding arbitration is optional,[715] and only twenty-eight signing jurisdictions have indicated their intent to apply it to their CTAs. [716] In general, the provisions of Part V of the MLI are required by signing parties of the MLI unless the CTA is covered by otherwise comparable dispute resolution measures. Finally, the MLI provisions do not even seek to address many of the OECD's primary concerns about BEPS. As the BEPS Project Actions indicate, many of the primary opportunities for BEPS are really the result of domestic laws rather than provisions in treaties. Domestic law must address issues such as characterising income to reflect what the OECD sees as economic reality, adjusting taxation of controlled foreign corporations (Action 3) and changing domestic law on transfer pricing (Action 13).[717]

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[709] Ibid art 11.

[710] Ibid art 9.

[711] 'Explanatory Statement' (n 7), note 2.

[712] Ibid, note 9, arts 12 to 15.

[713] Ibid.

[714] *Signatories and Parties to the Multilateral Convention* (n 42).

[715] Ibid.

[716] Ibid.

[717] *Action Plan on Base Erosion and Profit Shifting* (n 25) note 3.

Although this issue is not unique to the particular text of the MLI, the need for domestic laws to change in order to comprehensively reduce BEPS severely limits the effectiveness of the MLI at reducing BEPS. Thus, there are relatively few binding obligations that signing the MLI inherently entails. Binding provisions include the requirement to express a desire to avoid double taxation without providing opportunities for double non-taxation, adopt the principal purpose test, and commit to trying to reach an agreement with the other contracting tax jurisdiction on certain tax disputes arising under a CTA.[718]

However, the enforcement of these commitments is largely left to the individual tax jurisdictions. The mere fact that a tax jurisdiction ratifies the MLI does not inherently mean that it has committed to taking significant substantive measures to reduce BEPS.[719] Indeed, most of the optional articles of the MLI are not expected to be fully applied by the majority of signing jurisdictions.

7.5 Conclusions

Although the OECD performs a pivotal role in both international and domestic taxation, the OECD does not possess the power to bind tax jurisdictions through any binding process. Recommendations by the OECD must be ratified by tax jurisdictions by amendment to their domestic laws.

Work by the OECD to develop measures to reduce BEPS has to date failed to produce any impressive results. Hitherto, international economic law was built primarily on bilateral treaties (e.g., tax treaties and bilateral investment treaties (BITs) or multilateral treaties (the World Trade Organization agreements). The problem is that in some areas, like tax and investment, multilateral treaties have proven hard to negotiate, but only a multilateral treaty can be amended simultaneously by all its signatories.

The OECD aims to achieve a substantial reduction in BEPS by attempting to apply several of the action items identified as being particularly important in reducing BEPS. However, the impact of this document will likely be constrained by the selective, optional nature of many of its provisions, which do not require signing jurisdictions to commit themselves to taking significant measures to reduce BEPS. Indeed, some of the most influential tax jurisdictions have refused to even sign the MLI. While it likely reflects many increasingly accepted principles of international taxation, the MLI is likely to have a limited impact on global taxation and, more specifically, on reducing BEPS.

Whether the MLI will succeed in its quest to reduce the incidence of BEPS remains to be seen. While its adoption by multiple tax jurisdictions is an achievement, the absence of the United States is important, as is the fact that the other OECD members have agreed to only a limited set of provisions.[720] If the MLI is

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[718] *Multilateral Convention to Prevent BEPS* (n 322) arts 6, 7 and 16.

[719] As at 30 June 2021, 64 jurisdictions have ratified the MLI. See <https://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf>.

[720] See, eg, Avi Yonah and Xu (n 116).

successfully adopted by the majority of taxing jurisdictions, this will also have implications for non-taxing jurisdictions. For example, the PPT will likely be used by courts in signatory countries to interpret treaties with non-signatory countries like the United States if those countries have signalled their agreement with the single tax principle embodied in the PPT by, for example, incorporating the LOB in their tax treaties.[721]

Professor Kleist observed in 2018 that many of the measures proposed by the OECD in the 15 Actions listed in the BEPS Action Plan concern the design of the domestic laws of individual jurisdictions and thus presuppose that jurisdictions will be prepared to amend existing tax laws and/or introduce new laws that are consistent with the recommendations presented by the OECD. Kleist argues that in many cases, the adaptation of a state's domestic law on the basis of the OECD recommendations is aimed at increasing the taxing rights of that state in order to eliminate tax benefits that could otherwise have arisen through tax planning. As tax treaties limit the contracting states' taxing rights and generally have priority over domestic law, however, changes to the domestic law that increase a state's taxing rights may become ineffective where there is a tax treaty in place.[722]

As a consequence, basically all tax treaties entered into by the states that are involved in the BEPS Project must be amended in accordance with the domestic law changes proposed as part of the Final BEPS package, if these changes are to become fully effective. Furthermore, some of the measures of the Final BEPS package, such as the introduction of treaty anti-avoidance rules, specifically address tax treaty issues and thus require that changes be made to existing tax treaties. Professors Avi Yonah and Haiyan Xu suggest there are three reasons why an MTT makes more sense than a network of bilateral tax treaties. First, the rise of the GATT, subsequently the WTO, has shown that multilateral treaties governing important areas of international economic law are feasible if space is allowed for reservations (i.e., allowing countries to opt out of specific provisions). Adoption of the MLI and the OECD/G20 Inclusive Framework Two Pillars initiative are more recent multilateral developments. Second, many academic authors over the past 20 years have considered that a major obstacle to the development and acceptance of an MTT is that investment flows vary by each pair of countries, with the result that the appropriate withholding tax rates also vary.[723]

It can be argued that the reason for the remaining differences between the OECD and UN model tax treaties are retained because investment flows between developed countries are more reciprocal than flows between developed and developing countries. But even that is changing, as more developing countries become capital exporters as well as importers. In addition, it has for some time been recognised that it may be possible to

[721] Ibid.

[722] Ibid.

[723] Deloitte, 'Withholding Tax Rates 2017' (March 2017) <https://www2.deloitte.com/content/dam/Deloitte/global/Documents/Tax/dttl-tax-withholding-tax-rates.pdf>.

negotiate a multilateral treaty but leave the withholding tax rates to be settled by bilateral negotiation, as the UN model does. The new OECD MLI represents the culmination of this line of thinking. It is not a full-fledged multilateral tax convention covering all the areas that are usually covered by bilateral tax treaties. Instead, it is a global consensual treaty override designed to apply the results of BEPS simultaneously to all the tax treaties of countries that agree.[724]

Finally, the MLI provisions do not address many of the OECD's primary concerns about BEPS as many of the primary opportunities for BEPS result from the lack of coordination of domestic laws rather than provisions in treaties. Domestic law should address issues such as characterising income to reflect the OECD's interpretation of economic reality, adjusting taxation of controlled foreign companies (Action 3), and changing domestic law on transfer pricing (Action 13). Although this issue is not unique to the particular text of the MLI, the need for domestic laws to change in order to comprehensively reduce BEPS limits the effectiveness of the MLI to reduce BEPS.[725]

Thus, there are relatively few binding obligations that signing the MLI inherently entails. Binding provisions include the requirement to express a desire to avoid double taxation without providing opportunities for double non-taxation, adopt the principal purpose test, and commit to trying to reach an agreement with the other contracting tax jurisdiction on certain tax disputes arising under a CTA. However, the enforcement of these commitments is largely left to the individual tax jurisdictions. The mere fact that a tax jurisdiction ratifies the MLI does not inherently mean that it has committed to taking significant substantive measures to reduce BEPS. Indeed, most of the optional articles of the MLI are not expected to be fully applied by the majority of signing jurisdictions.[726]

In summary, the MLI appears to be somewhat of a 'quick fix' that may achieve its prime objective of providing an expeditious process for amending the global bilateral tax treaty network without addressing the three aspects of the current global tax treaty regime that are arguably largely responsible for BEPS:

- the bilateral architecture of the tax treaty regime *per se*;
- the disparate jurisdictional taxation laws that have developed under the bilateral tax treaty regime;
- the gaps and frictions that this system has generated, and which may arguably intensify given the added complications introduced by the MLI.

The following chapter presents the theoretical case for an MTT.

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[724] Avi-Yonah and Xu (n 116).

[725] Ibid.

[726] Ibid.

CHAPTER 8: THE CASE FOR A MULTILATERAL TAX TREATY

8.1 Introduction

In recent years, the issue of taxation has attracted a great deal of public debate and unprecedented attention from governments, citizens, boardrooms, senior management, and across businesses and their supply chains. Tax is at the forefront of negotiation and debate, and it is driving decisions on policy, trade, strategy, and business transformation. Contemporaneously, the global landscape has changed dramatically in terms of geopolitical shifts, technological innovation, globalisation, digital revolution, new business and consumer demands, entitlement concept, and the emergence of new business models.[727]

Corporate tax departments face new challenges, as they struggle to understand and apply to their organisation the rapidly changing domestic and global compliance obligations, elevate their strategic role, contribute to the environmental, social and governance agenda, and ensure they can clearly articulate how their departments can add value inside and outside of the organisation. In a similar vein, government taxation offices struggle to assess and implement the quantity of material emanating from the OECD and the academic commentary that follows. All of the above are putting pressure on senior tax officers to question their tax operating models and find new ways to structure their people, processes, and technology to meet the demands of the future.

It is now nine years since the OECD commenced its campaign to reduce the loss of corporate tax revenue, which occurs through tax havens, the erosion of the tax bases of tax jurisdictions, referred to as base erosion and profit shifting, and other causes. The global community has witnessed how tax jurisdictions have backed the OECD by adopting a number of strategies to prevent loss of tax revenue. To date, there is no published proof that the OECD activities of the past nine years have reduced tax avoidance. But there are clear indications that an increased burden has been placed on both governments and taxpayers.[728]

This chapter will argue that the current bilateral tax treaty regime is becoming increasingly ineffective in its response to events such as new technology, new business models, globalisation, and digitalisation. Accordingly, the OECD is compelled to introduce constant changes in an attempt to keep the regime functioning. These constant changes create uncertainty, complication, compliance issues, and increased costs for both government tax offices and taxpayers and have achieved very little in the way of reducing BEPS.

This thesis has established that the root cause of BEPS is the OECD bilateral model tax treaty that has together with the UN model tax treaty and the USA model tax treaty been adopted by over 3000 tax

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[727] 'Four Key Influences on the World of Tax', *KPMG* (Web Page, August 2019) <https://home.kpmg/xx/en/home/insights/2019/08/tax-is-changing.html>.

[728] Andrew Mills, '$50 billion compliance cost stands in the way of growth, warns tax law expert' (16 July 2021) *The Tax Institute*.

jurisdictions. This bilateral regime based on bilateral model tax treaties encouraged the unilateral development of domestic tax laws in an uncoordinated manner. With the wisdom of hindsight, it could be argued that a multilateral treaty should have been adopted by the League of Nations and later the OECD, but this employs the wisdom of hindsight. Without doubt these esteemed organisations considered the bilateral model the most appropriate choice at the time. That it would encourage the development of uncoordinated domestic tax laws was overlooked or under-valued. In any event, the failure to coordinate the development of domestic tax laws was an oversight by the responsible body.

8.2 Increasing Complexity

Whilst the MLI may provide a mechanism for the swift implementation of the OECD's anti-avoidance measures, it creates considerable complexity by providing a multitude of options for jurisdictions to opt in or out of various provisions. The reason for the enormous complexity of the global tax regime can arguably be traced back to the decision by the League of Nations, which was carried forward by the OECD, to adopt a bilateral model tax treaty that encouraged diversification of global tax standards, encouraged unilateral domestic tax laws, and necessitated the development of entities designed to meet specific requirements rather than to combine seamlessly with those of their trading partners.

The MLI allows jurisdictions to swiftly modify their tax treaties to reduce multinational tax avoidance and is a key component of the OECD's BEPS Project. Australia signed the MLI on 7 June 2017 and, following ratification on 26 September 2018, the MLI entered into force for Australia from 1 January 2019. Ratification by Australia is only the first step in the MLI's application to Australian double tax treaties ('DTA's). For the MLI to modify a particular DTA, both Australia and the relevant treaty partner need to identify that DTA as a CTA. Australia has identified all of its current tax treaties, apart from the DTA with Germany.[729]

Many of Australia's treaty partner countries either have not signed the MLI or, even if they have signed it, have not yet ratified the MLI, meaning that the impact of the MLI on Australia's treaties continues to evolve. Furthermore, while some of the Articles within the MLI are mandatory, most are optional, with the result that each of Australia's treaties may be affected differently, depending on the positions of both parties. For example, although Australia's treaties with both New Zealand and the United Kingdom have been modified by the MLI, only New Zealand and Australia have both ratified Article 8 (regarding dividend transfer transactions) and, therefore, the Australia–New Zealand treaty has been modified by Article 8 of the MLI. Conversely, as the United Kingdom hasn't ratified this particular article (even though Australia has), it won't apply to Australia's treaty with the United Kingdom.[730]

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[729] 'Multilateral Instrument' (n 43).

[730] Ibid.

Finally, each country may make reservations in relation to the MLI, which can modify how the standard OECD MLI clauses will apply to their CTAs. Australia has made several such reservations to the MLI clauses it is adopting, so these will also need to be reconciled with the position of its treaty partners.

Therefore, it will be of utmost importance to understand:

- Has the treaty partner signed and ratified the MLI?
- Which articles of the MLI has the treaty partner adopted?
- Has the treaty partner made any specific reservations in relation to the Articles it has adopted?
- What treaties are not modified by the MLI?

As at 22 August 2022, the following 10 treaties have not been modified by the MLI (based on current MLI positions or jurisdictions that have not signed the MLI): Austria, Germany Israel, Kiribati, Philippines, Sri Lanka, Sweden, Switzerland, Taiwan, and crucially the United States.[731]

Based on Australia's tax treaty partners' adopted position as at 22 August 2021, the MLI will over time modify 35 of Australia's 45 tax treaties.[732] Seven of Australia's tax treaty partners have not signed the MLI. Of particular significance is that the United States has not signed and is unlikely to change its position.[733]

The re-classification of tax-related entities adds significant complexity to cross-border transactions. Taxpayers and practitioners will need to understand which countries have signed and ratified the MLI, which agreements are CTAs, and the specific choices made by each jurisdiction in relation to the optional articles and alternative approaches. As the MLI has now entered into force in Australia, taxpayers need to assess the MLI's impact and consider whether changes to group structures, locations of people, or transactional flows would be advisable. If a particular treaty benefit is currently important, taxpayers should consider the likelihood of any potential change to that position under the MLI.

The argument that the MLI will be applied alongside existing tax treaties, rather than amending them, may prove difficult in practice. Logically, the end result may be a network of bilateral tax treaties, each individually drawn to operate within a dual set of legislative enactments and with the additional insertions, amendments, and procedures flowing from the MLI. As always with ground-breaking applications, difficulties with the interpretation and operation of the provisions of the MLI will follow and precipitate legal challenges in jurisdictional courts.[734]

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[731] 'Multilateral Instrument' (n 43).

[732] Deloitte, 'Tax Insights – Multilateral Instrument: State of play in 2021' (3 February 2021) <https://www2.deloitte.com/content/dam/Deloitte/au/Documents/tax/deloitte-au-tax-insights-1-mli-state-of-play-040221.pdf>.

[733] Ibid.

[734] Ibid.

Notwithstanding the originality of, and jurisdictional support for, the OECD/G20 inspired and produced BEPS Action Plan, the resulting MLI is disappointing. The complicated design of the MLI with the extraordinary number of options available adds another layer of complexity to an already highly regulated global tax regime. It is very likely that business managers of MNEs will experience difficulty in understanding the new system. The MLI does not address the underlying cause of BEPS – that is the bilateral tax treaty regime per se and the unique jurisdictional laws that have developed as a result. It is quite possible that the uncertainty and confusion the MLI will introduce may inadvertently create new gaps and frictions in the tax treaty network, which may facilitate new opportunities for BEPS. The OECD's determination to continue producing reports and actions based on an ancient model tax treaty, thousands of pages of commentaries, and a multilateral instrument designed to create uncertainty is difficult to comprehend.[735]

In addition to the above, the global tax treaty regime complexity is compounded by the following areas of complexity:

1. The current global tax regime is comprised of over 3,500 individually designed bilateral tax treaties.
2. The full version of the Model Tax Convention on which the bilateral tax treaties are largely based is 2624 pages in length.[736]
3. The MLI requires an Explanatory Statement to explain some of its provisions. The MLI also provides for jurisdictions to make 'choices' and 'reservations' and to 'opt out' of entire MLI articles, without needing a reason.[737]

Accelerating globalisation, digitalisation, and the proliferation of borderless entities, all suggest the increasing inability of a bilateral regime to exercise control. Continued failure to produce results will give tax jurisdictions little alternative but to return to a unilateral approach to taxation, which often entails offering competitive tax rates and other benefits.

8.3 Increasing Uncertainty

The multitude of undertakings by the OECD pursuant to the OECD Action Plan, in particular the development and operation of the MLI, have substantially increased the levels of uncertainty for both tax collectors and taxpayers. Business managers and their advisors need to operate in a relatively stable environment in order to conduct planning based on a stable global tax environment. During the past nine years, the OECD has produced a constant stream of publications relating to BEPS. This has created ongoing uncertainty for multilateral enterprises attempting to appropriately manage their corporations and comply

[735] Ibid.

[736] *Model Tax Convention 2017* (n 656).

[737] Cooper (n 118).

with constantly changing tax laws whilst meeting regulatory requirements to trade profitably, which amounts to a statutory duty in many jurisdictions to lawfully minimise tax.[738]

The arguments advanced in the preceding chapter with regard to complexity apply equally to uncertainty.

8.4 Increasing Cost of Compliance

On 16 July 2021, Andrew Mills, CTA (Life), Director of Tax Policy and Technical at The Tax Institute and former Australian Taxation Office Second Commissioner, launched The Tax Institute's report *The Case for Change*, which lays out how significant holistic change to Australia's tax system is vital in breaking the 20 years of sluggish growth in Australia.[739] Mills writes:

> 12 years ago, Ken Henry estimated that compliance with the tax law costs us an estimated $40 billion each year. Since then, costs have continued to grow, greater complexity has been piled onto the tax system for everyone. The true cost is likely over $50 billion now - over 14 times what it costs to run the ATO. A huge part of that cost is avoidable if we address the systemic issues of our system instead of continuing to tweak around the edges. You can put as many band-aids as you like on a broken limb, but it doesn't change the fact that it's broken. We need significant intervention, and we need expertise to undertake the right surgery.
>
> The taxation system's role is to fund our community and help it grow. To build roads and parks, fund public programs, medical and education services and pay pensions. Right now, we're in danger of it doing the opposite and ending up with a tax system that is an economic drain and a source of distrust between people, businesses, and government.[740]

According to Mills, Australia's GST revenue is already significantly lower than other OECD countries. Complexity in the system means that compliance costs consume an average 51% of that already low revenue of more than $155 million over five years. Mills advances that the taxes we rely on for 60% of revenue are among the most harmful for economic growth: corporate taxes (fourth-highest reliance globally) and personal income taxes (equal second-highest globally). He further states that contrary to public perception, most multinational corporations accused of 'not paying their fair share of tax' are not avoiding the law as they pay exactly what the law requires them to pay. The problem is the law hasn't kept up with what most people think is fair. This is a failing of successive governments to maintain a sustainable tax system.[741]

Mills points out that the regulators ignore heavy compliance costs, which leads to more complexity and bigger problems. Mills observes that our tax law is now more than 10,000 pages long and covers 125 taxes, with dozens of anti-avoidance measures and countless complex concessions with just ten of those taxes raising 90% of Australia's tax revenue. Mills advances the proposition that the government cannot keep

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[738] Ibid.

[739] Mills (n 728).

[740] Ibid.

[741] Ibid.

tacking on more measures and more inefficient and ineffective taxes and expect to have a working economy in a decade, nor a thriving one.[742] The level of complexity of Australia's taxation laws has substantially increased with the introduction of the measures intended to defeat BEPS, including the multilateral instrument. This will arguably cause a further increase in Australia's compliance costs.

In recent years, there has been a general acceptance of decentralised cryptocurrencies as a form of currency. This is significant because nobody appears to be supervising the activities of the cryptocurrency regime. Profits from trading in cryptocurrencies are generally treated as capital gains, but in the case of traders in cryptocurrencies, other methods of taxation appear more appropriate.[743] This developing area is unregulated and may add to the compliance costs of taxation authorities. An MTT would provide an arguably more effective instrument for the development of a global approach to the taxation of cryptocurrency-related activities and the future manifestations of digitalisation and globalisation.

On 20 December 2021, the OECD published detailed rules to assist in the implementation of a reform to the international tax system, which is intended to force MNEs to pay a minimum global tax rate of 15% from 2023. The Pillar Two model rules are intended to provide governments with a template for uniform rules for inclusion in domestic laws that, hopefully, will finally reduce base erosion and profit shifting arising from digitalisation and globalisation of the economy. This was agreed to in October 2021 by 137 countries and jurisdictions under the OECD/G20 Inclusive Framework on BEPS.[744]

The rules are intended to define the scope and set out the mechanism for the so-called 'GloBE rules' under Pillar Two, which is intended to introduce a global minimum corporate tax rate set at 15%. The minimum tax will apply to MNEs with revenue above EUR 750 million and is estimated to generate around USD 150 billion in additional global tax revenues annually. The GloBE rules provide for a co-ordinated system of taxation intended to ensure large MNE groups pay this minimum level of tax on income arising in each of the jurisdictions in which they operate. The rules create a "top-up tax" to be applied on profits in any jurisdiction whenever the effective tax rate, determined on a jurisdictional basis, is below the minimum 15% rate.[745]

The new Pillar Two model rules were published by the OECD on 20 December 2021 and will assist countries to bring the GloBE rules into domestic legislation in 2022. They provide for a co-ordinated system of interlocking rules that:

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[742] Ibid.

[743] Ibid.

[744] 'OECD Releases Pillar Two Model Rules for Domestic Implementation of 15% Global Minimum Tax', *OECD* (Web Page) <https://www.oecd.org/tax/beps/oecd-releases-pillar-two-model-rules-for-domestic-implementation-of-15-percent-global-minimum-tax.htm.

[745] Ibid.

- define the MNEs within the scope of the minimum tax;
- set out a mechanism for calculating an MNE’s effective tax rate on a jurisdictional basis, and for determining the amount of top-up tax payable under the rules; and
- impose the top-up tax on a member of the MNE group in accordance with an agreed rule order.[746]

How this will work in practice is another matter.

8.5 Response to Future Global Taxation Developments

The world is changing as the focus on reversing what are widely believed to be the effects of global climate change is incorporated in amendments to tax laws. As part of the European Green Deal, the European Commission (EU) has set out targets to address climate change and to achieve a less polluted future global environment. The EU plan seeks a 55% reduction in greenhouse gas emissions by 2030 and to become a climate-neutral continent by 2050. One of the means by which authorities including the EU plan to achieve these targets is through environmental or green taxes including taxes on energy, transport, pollution, and resources. Energy taxes are taxes on energy products and electricity used for transport, such as petrol and diesel, and for other purposes, such as fuel oils, natural gas, coal, and electricity used in heating.[747]

The rapid shift away from petrol, coal, and the many other commodities and activities considered to contribute to climate change, will cause a substantial financial redistribution of wealth and a reduction in certain taxes including royalties on mining products. In Australia, this will impact Queensland and Western Australia and already there have been moves by the Queensland Government to introduce new taxes and to extend existing ones. One example of this is that from 30 June 2023, land tax will be calculated on the whole of an entity's Australian-based landholding using the current Queensland land tax rates and thresholds. Tax will then be applied on the proportion the Queensland land value bears to the total Australian land value.[748] Reference: Queensland Government, https://www.qld.gov.au/environment/land/tax/interstate.

8.6 Failure of the OECD/G20 BEPS Action Plan to Reduce BEPS

Nicholas Shaxson, writing for the International Monetary Fund in 2019, observed that the billions attracted by tax havens do harm to sending and receiving nations alike.[749] He observed that tax havens collectively cost governments between $500 billion and $600 billion a year in lost corporate tax revenue, depending on

[746] Ibid.

[747] ‘Green Taxation’, *European Commission* (Web Page) <https://taxation-customs.ec.europa.eu/green-taxation-0_en>

[748] ‘Interstate properties and land tax’, *Queensland Government* (Web Page) <https://www.qld.gov.au/environment/land/tax/interstate>.

[749] Nicholas Shaxson, ‘Tackling Tax Havens, article written for International Monetary Fund’ (September 2019) 56(3) *Finance & Development* 6.

the estimate through legal and illegal means.[750] Of that lost revenue, low-income economies account for some $200 billion — a larger hit as a percentage of GDP than advanced economies, and more than the approximately $150 billion they receive each year in foreign development assistance. American Fortune 500 companies alone held an estimated $2.6 trillion offshore in 2017, though a small portion of that has been repatriated following US tax reforms in 2018.[751]

Corporations are not the only beneficiaries. Individuals have transferred $8.7 trillion to tax havens, estimates Gabriel Zucman, an economist at the University of California at Berkeley.[752] Economist and lawyer James S. Henry's more comprehensive estimates yield an astonishing total of up to $36 trillion.[753] Both, assuming very different rates of return, put global individual income tax losses at around $200 billion a year, which must be added to the corporate total.[754]

No OECD statistics on BEPS appear available. Statistics were immediately produced when the BEPS Action Plan was first proposed but nothing has been released since that time, which suggests that statistics favourable to the reduction of BEPS do not exist.[755]

8.7 Advantages and Disadvantages of a Multilateral Tax Treaty

An MTT is a treaty established between three or more jurisdictions with the intention of:

1. reducing the overall complexity of the current bilateral tax regime by reducing the total number of tax treaties from well in excess of 3,000 tax treaties to one MTT
2. standardising the individual domestic tax laws that have been unilaterally adopted by tax jurisdictions to reduce the incidents of frictions and mismatches between the tax laws of tax jurisdictions
3. facilitating the amendment of tax treaties through far less complicated processes
4. more effectively addressing BEPS by harmonising jurisdictional tax laws and treaties[756]
5. standardising regulations — companies can more easily navigate tax laws between signatory countries to an MTT rather than via a multitude of bilateral tax treaties with all its trading partners,

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[750] Ernesto Crivelli, de Mooij, Ruud and Michael Keen, 'Base Erosion, Profit Shifting and Developing Countries' (IMF Working Paper 15/118, International Monetary Fund, 2015).

[751] Ibid.

[752] Gabriel Zucman, *The Hidden Wealth of Nations* (University of Chicago Press, 2016).

[753] James S. Henry, 'Taxing Tax Havens: How to respond to the Panama Papers' *Foreign Affairs* (online, 12 April 2016) <https://www.foreignaffairs.com/articles/belize/2016-04-12/taxing-tax-havens>.

[754] Shaxson (n 749).

[755] *Action Plan on Base Erosion and Profit Shifting* (n 25) 15.

[756] 'Multilateral Agreement: Everything You Need to Know', *Upcounsel* (Web Page) <https://www.upcounsel.com/multilateral-agreement>.

thousands of pages of commentaries, the MLI and the need to investigate the current MLI elections of each trading partner

6. reducing competition for mobile capital and maintaining tax rates
7. reducing compliance costs for taxpayers and tax collectors
8. encouraging tax havens to become signatories of the MTT
9. levelling the playing field for all tax jurisdictions with one MTT[757]
10. encouraging and producing cooperation among all tax jurisdictions rather than the ongoing struggle between developed and developing countries for tax revenue.

The disadvantages of an MTT include:

1. ceding of sovereign rights — this can create a difficult political position for jurisdictions that are partners in an MTT as it involves surrendering a degree of sovereignty over the way they impose and collect taxes
2. reduced scope for countries to attract capital and corporations to their jurisdiction
3. possibly lengthy negotiations for an MTT, due to the complex nature of such a treaty that may require countries with competing interests to mitigate their positions
4. the confidential nature of negotiations for an MTT, which could breed mistrust and controversy between jurisdictions and corporations
5. difficulties in obtaining the signatures of the larger economies.[758]

8.8 Conclusion

Globalisation, rapidly advancing technology, digitalisation, and new business concepts and models have dramatically changed the environment in which tax is levied and collected. Most financial transactions and business operations are performed via available technology at the speed of light. Aging populations and the age of entitlement will place increasing funding pressures on governments, which rely on taxation to fund their expenditure.

Figures released by the Australian Government in 2021 revealed that social security and welfare consumed 35.6% of the government’s income from taxes and that health consumed 16.7%, and the cost of supporting welfare recipients and of providing high levels of medical care will almost inevitably increase.[759]

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[757] Ibid.

[758] Ibid.

[759] Australian Government, ‘Budget 2021-2022’ <https://budget.gov.au/2021-22/content/overview.htm>.

In addition to the above, the National Disability Scheme is currently requiring annual funding of $21.5 billion in 2019–2020.[760] Furthermore, the incoming labour party government is committed to reducing emissions by 43% by 2030.[761]

Tax avoidance needs to be resolved as a matter of urgency to preserve the revenue bases of tax jurisdictions throughout the world. This is exemplified by the breakdown of supply chains, reduction in the timely provision of goods and the economic downturn as by-products of the activities by Russia in Ukraine.

Developing tensions between China and other Pacific countries including Australia will place increasing pressure on the Australian Government to develop a defence plan for Australia and our Pacific Region that utilises our unique advantages of global positioning and available resources.

There is a rapidly and globally developing cult of entitlement that is particularly evident among the under-30-years-of-age cohort. The availability of information and vision of the extravagant lifestyles of the rich and famous fuels this expectation of financial support provided by governments. This sense of entitlement is also fuelled by the marketing strategies adopted by both government advertising agencies and those of private enterprises and forces governments to provide escalating levels of financial support to hold office.

The following chapter is about conceptualising and implementing an MTT.

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[760] 'Paying for the National Disability Scheme', *Parliament of Australia* (Web Page) <https://www.aph.gov.au/About_Parliament/Parliamentary_Departments/Parliamentary_Library/pubs/BriefingBook45p/NDIS#:~:text=How%20much%20will%20it%20cost,1.1%20per%20cent%20of%20GDP>.

[761] Jacob Greber, 'Steelmakers, smelters may be paid to cut emissions' *Financial Review* (online, 17 August 2022) <https://www.afr.com/policy/energy-and-climate/steelmakers-smelters-may-be-paid-to-cut-emissions-20220817-p5bamh>.

CHAPTER 9: CONCEPTUALISING AND IMPLEMENTING A MULTILATERAL TAX TREATY

9.1 Introduction

Earlier chapters have established the theoretical basis for the development of an MTT. This chapter will attempt to identify the core elements of the proposed MTT and formulate a process for designing and implementing the MTT. In order to attain this outcome, the recent and present role undertaken by the OECD will be examined.

As described in Chapter 3, the forerunner of the OECD was the Organisation for European Economic Co-operation, which was formed to administer American and Canadian aid under the Marshall Plan for the reconstruction of Europe after World War II.[762]

The Convention transforming the OEEC into the OECD was signed at the Chateau de la Muette in Paris on 14 December 1960 and entered into force on 30 September 1961.[763]

Since then, the OECD's vocation according to the OECD website, has been to:

> Deliver greater well-being worldwide by advising governments on policies that support resilient, inclusive, and sustainable growth. Through evidence-based policy analysis and recommendations, standards, and global policy networks, including close collaboration with the G7 and the G20, the OECD has helped advance reforms and multilateral solutions to global challenges. This spans the public policy horizon, from the polluter pays principle, which the OECD developed in the 1970s, to PISA in education, not to mention tax transparency and artificial intelligence. Throughout its history, the OECD has striven to become more global, more inclusive, and more relevant.[764]

Since 2013 and the publication of its report *Addressing Base Erosion and Profit Shifting*, the OECD has published many reports on various aspects of BEPS (see n 90) and has managed to obtain overwhelming support from the majority of global tax jurisdictions in the following undertakings:

- exchange of information
- development and implementation of the multilateral instrument
- Two Pillars program

The OECD has the detailed knowledge of the following aspects of global tax that identifies the OECD as virtually the only current, serious candidate for the role of global tax authority:

1. unique knowledge of the OECD Model and its strengths and weaknesses

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[762] OECD, *A Brief History* (Web Page) <https://www.oecd.org/60-years/>.

[763] Ibid.

[764] Ibid.

2. unique knowledge of the global tax jurisdictions and their domestic tax rules
3. a deep understanding of the tax needs and aspirations of both developed and developing countries
4. the experience necessary to bring together a majority of tax jurisdictions as signatories of the MTT
5. the knowledge of and access to suitably qualified persons likely to form an initial committee to develop an operational plan for the transition of a bilateral tax treaty regime to an MTT regime.

This brief introduction to the OECD will be expanded in Section 9.3 to a proposal for the OECD to accept the role of global taxation authority and to initiate the global machinations for the design of an MTT acceptable to a majority of both developed and developing tax jurisdictions.

9.2 Key Multilateral Provisions

9.2.1 Neutralising the Effects of Hybrid Mismatch Arrangements

The objective of Articles 3–5 of the MLI is to deal with so-called hybrid mismatches. The bilateral architecture of the OECD Model tax treaty has encouraged the development of uncoordinated jurisdictional tax systems (domestic laws), resulting in legal concepts that may have different meanings and functions in different jurisdictions. Taxpayers can take advantage of these mismatches in their tax planning. For example, a payment under a financial instrument may be classified in the jurisdiction of the payer as deductible interest while being classified as tax-exempt dividends in the jurisdiction of the recipient, thereby resulting in double non-taxation.[765]

Congruently, a legal entity may be regarded as transparent for tax purposes in its home jurisdiction but be classified as a taxable entity in the jurisdiction in which the owners are residents. This can result in non-taxation of income derived by that entity. Lack of coordination of tax systems can also lead to a deduction being allowed for the same cost in more than one jurisdiction. Article 3 addresses certain forms of tax planning that entail income earned through transparent entities. It implements the new Article 1(2) of the *OECD Model Tax Convention*, which has been included in the 2017 version of the model treaty, and also modifies the provisions concerning the elimination of double taxation.[766]

Where a taxpayer is considered by each contracting jurisdiction to a tax treaty to be a resident of that jurisdiction under the treaty, it may result in a double deduction for the same costs (i.e., deduction in both jurisdictions) and other unintended tax benefits. Article 4 of the MLI deals with these situations of dual residence for taxpayers other than individuals and is based on the new text of Article 4(3) of the OECD Model, which has been included in the 2017 version of the model treaty.[767] The goal is to ensure that a taxpayer is considered a resident of only one contracting jurisdiction. This is achieved by means of a mutual

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[765] See, eg, *Addressing Base Erosion and Profit Shifting* (n 23).

[766] Kleist (n 120).

[767] *Model Tax Convention 2017* (n 656).

agreement procedure. Furthermore, Article 4 of the MLI provides that, if the contracting jurisdictions cannot agree, the taxpayer is not entitled to tax relief under the treaty, except to the extent agreed upon by the competent authorities of the contracting jurisdictions.[768]

Article 5 of the MLI modifies the double-tax-relief article of existing treaties in order to avoid double nontaxation because of the application of the exemption method to income that is not taxed in the jurisdiction of source. The article provides three options:

Option 1

The first option, which is based on Article 23A (4) of the *OECD Model Tax Convention*, provides for a switch to the credit method when the source jurisdiction applies the provisions of an existing tax treaty to exempt income or to limit the rate at which that income may be taxed.

Option 2

The second option also provides for a conversion to the credit method but is limited to situations in which the jurisdiction of residence would otherwise have exempted the income because it treats it as dividends, whereas the source jurisdiction allows a deduction for the payment under its domestic laws, characteristically as a result of categorising it as a payment of interest. This option was prepared in conjunction with the MLI and is not included in any prior report.

Option 3

The third option is to replace the double-tax-relief article of existing tax treaties that provide for the exemption method with a double-tax-relief article that provides for the credit method. Unfortunately, the entirety of Part 11 of the MLI, addressing what the OECD calls 'hybrid mismatches' is optional for signing parties.[769] It follows from this that the mere signing of the MLI does not necessarily bind the tax jurisdiction to classify transparent entity income as that of a resident, take measures to prevent double non-taxation, or do anything to address Action Two of the BEPS Project.[770]

Treaty abuse is another area of BEPS that was addressed by the OECD in the BEPS Action Plan.[771]

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[768] Ibid art 4.

[769] See, eg, Morley (n 117).

[770] *Multilateral Convention to Prevent BEPS* (n 322).

[771] Ibid.

9.2.2 Preventing Treaty Abuse

Action 6 of the BEPS Action Plan is concerned with the development and implementation of anti-avoidance provisions and recommendations regarding the design of domestic laws to prevent the granting of treaty benefits in inappropriate circumstances.[772] The work will be co-ordinated with the work on hybrids.[773]

Limitation on benefits ('LOB') clauses and similar anti-abuse tools are designed to attempt to preserve and protect the bilateral nature of specific tax treaties when two individual countries have agreed to eliminate double taxation by negotiating tailor-made rules, for example, on the level of withholding taxation, the scope of the PE concept, or the use of the exemption method versus the credit method. As the negotiation process between those two countries is meant to award treaty benefits on a reciprocal basis only, LOB clauses, and generally the PPT, are employed to deny those treaty benefits to residents of third countries who set up intermediate companies, establish conduit structures, or use other arrangements (like a temporary shift of corporate residence) to reap those benefits.[774] This area of tax avoidance would be eliminated by a multilateral treaty.

It can be argued that the anti-abuse tools under Action 6 of the BEPS Action Plan do not fundamentally represent a new multilateral standard but represent an attempt to patch up the deficiencies of the existing international tax treaty network without moving forward to a new standard. For example, a common level for withholding taxation or a more harmonised approach to what constitutes a permanent establishment would be achieved by an MTT. It is significant that this most important minimum standard agreed on for tax treaties employs reverse engineering to look backward and attempt to solve bilateral issues that would never come up in a multilateral tax system.[775]

The BEPS Action 6 Final Report states that tax arbitrage is specifically addressed by other Actions (e.g. Action 2 on hybrids) but that it has to be left to domestic tax legislation whether gaps between domestic tax systems can be filled.[776] The OECD is responsible for creating the current bilateral mismatch of domestic tax laws and should resolve the issue by admitting the failure of the bilateral tax regime and starting the processes necessary to garner jurisdictional approval for a multilateral treaty. The only role the PPT can play in this context is to make sure that treaty law does not get in the way of domestic SAARs and GAARs, whenever they are needed to fight the unintended non-taxation of income.[777]

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[772] Ibid.

[773] *Action Plan on Base Erosion and Profit Shifting* (n 25) 242.

[774] Ibid.

[775] Ibid.

[776] OECD, *OECD/G20 Action 6 Final Report* (OECD Publishing).

[777] Ibid 82 et seq.

It is noteworthy that the United States did not sign up to the PPT template provided under Action 6 of the BEPS Action Plan. The minimum standard established under Action 6 does not require the implementation of the PPT under all circumstances. Rather, countries can decide to use extensive LOB clauses and conduit rules in order to address two major cases of treaty abuse. This is what the United States has done by amending the US Model in 2016 in line with Action 6. This exemplifies the 'individual approach' that has underpinned US treaty policies for many decades. It also makes clear that the PPT, as such, has not reached the status of a globally agreed standard.[778]

Treaty abuse is one of the most important causes of BEPS concerns. The Commentary on Article 1 of the *OECD Model* already includes several examples of provisions that could be used to address treaty-shopping situations and other cases of treaty abuse that may give rise to double non-taxation. The provisions of the MTT should include tight treaty anti-abuse clauses that, coupled with the exercise of taxing rights under domestic laws, will contribute to the restoration of source taxation.[779]

Articles 6–11 of the MLI address various forms of tax planning that can be perceived as treaty abuse. Article 6 of the MLI modifies existing tax treaties to include a preamble text that clarifies the purpose of the double tax treaty as not being solely to eliminate double taxation but to do so without creating opportunities for non-taxation or reduced taxation through tax evasion or tax avoidance. This can include treaty-shopping arrangements designed to obtain relief provided in the tax treaty for the indirect benefit of third jurisdiction residents.[780]

Article 7 of the MLI presents an anti-abuse provision in the form of the PPT, which since the 2017 update is also included in Article 29(9) of the *OECD Model*. The PPT provision provides that treaty benefits shall be denied 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.[781]

In addition, Article 7 contains an optional 'simplified' LOB clause, covering approximately four pages, which provides that most treaty benefits shall be denied to taxpayers other than individuals unless such other taxpayers fulfil one of several criteria. The purpose of the clause is to prevent treaty shopping by denying treaty benefits to entities that are not engaged in the 'active conduct of business.'[782]

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[778] Wolfgang Schon, 'Is there Finally an International Tax System?' (2021) 13(3) *World Tax Journal*.

[779] Ibid.

[780] Ibid.

[781] *Model Tax Convention 2017* (n 656) art 29(9).

[782] Ibid.

Avi Yonah and Xu observe that in order to address situations of treaty abuse, the Action 6 Report requests that countries implement: [783]

- a principal purpose test ('PPT') only;
- a PPT and either a simplified or detailed LOB provision;
- a detailed LOB provision, supplemented by a mechanism that would deal with conduit arrangements not already dealt with in tax treaties.[784]

Although the PPT is intended to identify the purpose behind the arrangement or transaction, this test is objective, rather than subjective, in terms of practical operation. Under the compatibility clause in article 7(2), article 7(1) shall apply in place of or in the absence of provisions of a CTA that deny all or part of the benefits that would otherwise be provided where the principal purpose, or one of the principal purposes, of any arrangement or transaction, or of any person concerned with an arrangement or transaction, was to obtain those benefits.[785]

Where parties disagree on its application, the PPT alone applies symmetrically by default. However, it is problematic where one party chooses the simplified LOB provision and opts out of article 7 entirely, while another contracting party chooses not to apply the simplified LOB provision. To avoid such deadlock in the bilateral relationship, the simplified LOB provision shall apply when some but not all Contracting Jurisdictions have chosen to apply it, provided that there is agreement under article 7(7)(a) or (b).[786]

The most prominent element of the minimum standards requiring all Member States of the Inclusive Framework of the OECD to update their tax treaties is to be found in Action 6 on the 'granting of treaty benefits in inappropriate circumstances'. The mandatory introduction of a general anti-abuse clause for international transactions in 2017 was included in article 29(9) of the OECD Model. The wording of the clause runs as follows:

> Notwithstanding the other provisions of this Convention, a benefit under this Convention 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 this Convention.[787]

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[783] Avi-Yonah and Xu (n 114).

[784] 'Explanatory Statement' (n 7) 22.

[785] Avi-Yonah and Xu (n 114).

[786] *Model Tax Convention 2017* (n 656) art 7(7).

[787] Ibid.

It remains to be seen to what extent the new clause will change global administrative and court practice.[788] There seems to be a general consensus that its impact will depend largely on the willingness of courts to develop a common understanding of the language used in the PPT. The question of whether this new anti-abuse clause in tax treaties can be regarded as a cornerstone for a coherent international tax regime should not be overlooked which situations this clause is meant to address. Most treaty abuses, in particular treaty shopping situations, by their very definition only come up whenever countries have explicitly not reached common standards and practices at the global level.[789]

9.2.3 Preventing the Artificial Avoidance of Permanent Establishment Status

The treaty provisions regarding Permanent Establishment and their interaction with jurisdictional tax laws have long been a fertile area for tax avoidance to flourish. The MTT should include changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues should also address related profit attribution issues.[790]

> There is general acceptance that the definition of permanent establishment (PE) must be updated to prevent abuses. In many jurisdictions, the interpretation of the treaty rules on agency PE allows contracts for the sale of goods belonging to a foreign enterprise to be negotiated and concluded in a jurisdiction by the sales force of a local subsidiary of that foreign enterprise without the profits from these sales being taxable to the same extent as they would be if the sales were made by a distributor.[791]
>
> In many cases, this has led enterprises to replace arrangements under which the local subsidiary traditionally acted as a distributor by "commissionaire arrangements" with a resulting shift of profits out of the jurisdiction where the sales take place without a substantive change in the functions performed in that jurisdiction. Similarly, multinational enterprises (MNE)s may artificially fragment their operations among multiple group entities to qualify for the exceptions to PE status for preparatory and ancillary activities.[792]

Cooper observes that Article 13 offers two models for tightening the definition of PE and Australia has chosen Option A. Regardless of what the treaty says, a place of business shall only be deemed not to be a PE if the activity conducted at the place of business is of a preparatory or auxiliary character.[793]

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[788] Ibid.

[789] Ibid.

[790] Author's note: The multilateral tax treaty should theoretically include the 'anti-abuse rule for permanent establishments situated in third jurisdictions' as presented in Article 10 of the *Multilateral Convention to Prevent BEPS* (n 322).

[791] *Multilateral Convention to Prevent BEPS* (n 322).

[792] Ibid art 12.

[793] Cooper (n 118).

Professor Avi-Yonah commented that based on article 5(6)(a) of the OECD *Model Tax Convention* produced in the Action 7 Report,[794] article 12(2) clarifies that article 12(1) 'shall not apply where the person acting in Contracting Jurisdiction X on behalf of an enterprise of Contracting Jurisdiction Y carries on business in Jurisdiction X as an independent agent and acts for the enterprise in the ordinary course of that business'.[795] 'Where, however, a person acts exclusively or almost exclusively on behalf of one or more enterprises to which it is closely related, that person shall not be considered to be an independent agent with respect to any such enterprise'.[796]

The compatibility clause in article 12(3) describes the interaction between article 12(1) and (2) and various existing provisions.[797] Article 12(1) 'would replace existing provisions describing the conditions under which an enterprise shall be deemed to have a PE in a Contracting Jurisdiction in respect of an activity which a person other than an independent agent undertakes for the enterprise, but only to the extent that such provisions address the situation in which the person has, and habitually exercises, authority in that Contracting Jurisdiction to conclude contracts in the name of the enterprise'.[798]

However, article 12(1) would not apply to a provision providing that an enterprise can be deemed to have a PE for a reason other than an authority to conclude contracts that are binding on another enterprise.[799] Article 12(2) would replace existing provisions providing 'that an enterprise shall not be deemed to have a PE in a Contracting Jurisdiction in respect of an activity which an agent of an independent status undertakes for the enterprise'.[800]

Given that provisions addressing the issues of article 12 are not required to meet the minimum standard,[801] article 12(4) allows a Party to opt out of article 12 entirely.[802] The notification clauses in article 12(5) and (6) clarify that article 12(1) or (2) would apply with respect to an existing provision only where all Contracting Jurisdictions to such Agreement have made such a notification.

Artificial Avoidance of PE Status Through the Specific Activity Exemptions Article 13 is intended to reflect the changes brought by the Action 7 Report to the wording of article 5(4) of the OECD *Model Tax Convention* of 2014, so as to address situations in which the specific activity exemptions give rise to BEPS

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[794] Avi-Yonah and Xu (n 114).

[795] Ibid.

[796] *Multilateral Convention to Prevent BEPS* (n 322) art 12(2).

[797] Ibid art 12(3).

[798] Ibid art 12(3)(a).

[799] Ibid.

[800] Ibid art 12(3)(b).

[801] Ibid.

[802] Ibid note 24, art 12(4).

concerns.[803] Article 13(1) permits a Party to choose to apply Option A or Option B or to apply neither Option.[804] To address concerns of artificial avoidance of PE status through the specific activity exemptions, Option A explicitly states that the activities listed therein will be deemed not to constitute a PE only if they are of a preparatory or auxiliary character, including:

1. the activities specifically listed in [existing provisions] as activities deemed not to constitute a PE, whether or not that exception from PE status is contingent on the activity being of a preparatory or auxiliary character
2. the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a) and
3. the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b).[805]

Option B is designed as an alternative provision to address inappropriate use of the specific activity exemptions through anti-fragmentation rules.[806] The term 'PE' shall be deemed not to include:

- the activities specifically listed in the [existing provisions] as activities deemed not to constitute a PE, whether or not that exception from PE status is contingent on the activity being of a preparatory or auxiliary character, except to the extent that the relevant [existing] provisions provide explicitly that a specific activity shall be deemed not to constitute a PE provided that the activity is of a preparatory or auxiliary character
- the maintenance of a fixed place of business solely for the purpose of carrying on, for the enterprise, any activity not described in subparagraph a), provided that this activity is of a preparatory or auxiliary character; c) the maintenance of a fixed place of business solely for any combination of activities mentioned in subparagraphs a) and b), provided that the overall activity of the fixed place of business resulting from this combination is of a preparatory or auxiliary character.[807]

9.2.4 Making Dispute Resolution Mechanisms More Effective

It is generally accepted that the application of the MLI to the existing tax treaty network will increase the number of tax-related disputes, which is a cause of concern for the international tax environment. For this reason, the OECD has invested heavily in making dispute resolution more effective. This section will examine in detail the OECD's work in this regard.

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[803] Ibid note 24, 168.

[804] Ibid note 24, art 13(1).

[805] Ibid art 13(2).

[806] Ibid note 24, 169.

[807] Ibid note 24, art 13(3).

The OECD set out to develop solutions to address obstacles that prevent jurisdictions from solving treaty-related disputes under mutual agreement procedures (‘MAP’), including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases.

The OECD proposed that the actions to counter BEPS must be complemented with actions that ensure certainty and predictability for business. Work to improve the effectiveness of the MAP will be an important complement to the work on BEPS issues. The interpretation and application of novel rules resulting from the work described above could introduce elements of uncertainty that should be minimised as much as possible. Work will therefore be undertaken in order to examine and address obstacles that prevent countries from solving treaty-related disputes under the MAP. Consideration will also be given to supplementing the existing MAP provisions in tax treaties with a mandatory and binding arbitration provision.[808]

Close collaboration between the competent authorities based on jointly agreed procedural and operational rules is needed to ensure the smooth and predictable functioning of the arbitration process. Article 19(10) therefore requires that the competent authorities ‘settle the mode of application of the [arbitration] provisions [by mutual agreement] - including the minimum information necessary for each competent authority to undertake substantive consideration of the case. Such an agreement shall be concluded before the date on which unresolved issues in a [MAP] case are first eligible to be submitted to arbitration’.[809]

‘First, any unresolved issue arising from a MAP case shall not be submitted to arbitration if a decision on this issue has already been rendered by a court or administrative tribunal of either Contracting Jurisdiction. Second, the arbitration process shall terminate if a court or administrative tribunal decision is rendered during the arbitration process’.[810]

Type of Arbitration Process

Article 23 offers the ‘final offer’ approach and the ‘independent opinion’ approach as default types to expedite the arbitration process.[811] However, the competent authorities may mutually agree on different rules. Under the ‘final offer’ approach, ‘the competent authorities shall each submit to the panel a proposed resolution which addresses all unresolved issues in the case but including only the disposition of specific monetary amounts or the maximum rate of tax charged pursuant to the Covered Tax Agreement’.[812]

Where the unresolved issues include threshold questions, ‘such as whether an individual is a resident or whether a permanent establishment exists, the competent authorities may submit alternative proposed

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[808] *Action Plan on Base Erosion and Profit Shifting* (n 25).

[809] *Multilateral Convention to Prevent BEPS* (n 322) art 19(10).

[810] Ibid art 19(12)(b).

[811] Ibid note 24, art 23(1).

[812] Ibid art 23(1)(a).

resolutions contingent on resolution of the unresolved threshold questions'.[813] Each competent authority may submit a supporting position paper or a reply submission in response to the other competent authority's proposed resolution and supporting position paper.[814] The panel shall select one of the proposed resolutions and shall not include a rationale or any other explanation of the decision.[815]

A Party unwilling to accept the 'final offer' approach may adopt the 'independent opinion' approach.[816] Each competent authority shall provide all panel members with any information necessary for the arbitration decision.[817] The panel shall decide the issues pursuant to the applicable provisions of the CTA and, subject to these provisions, of the domestic laws of the Contracting Jurisdictions. The panel shall also consider any other sources identified by mutual agreement between the competent authorities.[818] The decision shall indicate the sources of law relied upon and the reasoning which led to its result. The arbitration decision shall be delivered to the competent authorities in writing but will not have any precedential value.[819] Where two parties prefer different types of arbitration processes, the competent authorities shall endeavour to reach agreement on the type of arbitration process that applies to all cases arising under that CTA.[820] Until such an agreement is reached, Article 19 shall not apply.[821] A Party may choose to apply article 23(5) 'with respect to its Covered Tax Agreements'.[822]

Professor Kleist observed that 'when isolated from the accompanying rhetoric, the proposed changes to the OECD Model are four in total'.[823]

Despite the efforts to resolve many of the BEPS Project's concerns, the MLI itself ultimately does not appear to provide final solutions to the BEPS problem and may prove largely ineffective at reducing BEPS.[824] Furthermore, it risks compounding an already complicated and global tax regime by adding confusion and uncertainty. As the MLI itself indicates, it is 'flexible'.[825]

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[813] Ibid.

[814] Ibid art 23(1)(b).

[815] Ibid art 23(1)(c).

[816] Ibid art 23(2.

[817] Ibid art 22(2)(a).

[818] Ibid art 2.

[819] Ibid.

[820] Ibid art 23 (3).

[821] Ibid.

[822] Ibid art 23(4).

[823] Kleist (n 120).

[824] Morley (n 117).

[825] 'Frequently Asked Questions' (n 619).

While in some cases this means that the MLI provides multiple options for signing jurisdictions, in many cases, this provides tax jurisdictions with the opportunity to reject entire provisions of the MLI. This may create uncertainty for both tax departments and taxpayers. The impact of a tax jurisdiction's rejection of an MLI provision is magnified by the fact that where one of the parties to a CTA has made reservations against a provision of the MLI, the provision will not apply to that CTA.[826] Nevertheless, there are some mandatory provisions within the MLI although they are relatively few in number.[827] As a result, signing the MLI does not mean that tax jurisdictions are committing to abide by all, or even most, of the MLI's provisions.

9.2.5 Global Allocation of Profits of Certain Multinationals

In recent years the OECD has obtained considerable support in the development of its Two-Pillar Solution for 'addressing the tax challenges arising from the digitalisation of the economy'.[828] According to this report, the Inclusive Framework on BEPS is intended to 'address key terms for an agreement on a two-pillar approach to help address tax avoidance, ensure coherence of international tax rules, and, ultimately, a more transparent tax environment'. His report states that BEPS 2.0 is also designed to address the challenges arising from the taxation of the digital economy. Pinto wrote about this in 2014 in *A Preliminary Analysis of Potential Options to Address the Tax Challenges Raised by the Digital Economy.*[829] Pinto made two suggestions that are relevant to this discussion:

1. Create a global withholding tax for major MNEs.[830]
2. Do not attempt to 'ring fence' the digital economy 'as the digital economy is increasingly becoming the economy itself'.[831]

On 20 December 2021, the OECD/G20 Inclusive Framework on BEPS released the GloBE rules under Pillar Two. These rules set forth the 'common approach' for a Global Minimum Tax rate of 15% for MNEs with an annual turnover of more than EUR750 million. Commentary related to the GloBE rules was released on 14 March 2022.[832]

9.3 Conceptualising a Multilateral Tax Treaty

Previous chapters have provided irrefutable proof in support of the two thesis hypotheses:

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[826] Bernstein (n 664).

[827] *Multilateral Convention to Prevent BEPS* (n 322) art 19(4).

[828] OECD, 'Fact Sheet Amount A' (25 August 2022) <https://www.oecd.org/tax/beps/pillar-one-amount-a-fact-sheet.pdf>.

[829] Pinto, 'A Preliminary Analysis' (n 75).

[830] Ibid 35.

[831] Ibid 54.

[832] 'BEPS 2.0: Pillar One and Pillar Two', *KPMG* (Wep Page, 25 August 2022) https://home.kpmg/xx/en/home/insights/2020/10/beps-2-0-pillar-one-and-pillar-two.html.

1. The bilateral architecture of the current international tax treaty network, and the individual domestic tax rules it has generated, are significant facilitators (rather than inhibitors) of base erosion and profit shifting.
2. An MTT can, at least theoretically, be more effective in combatting base erosion and profit shifting than the current bilateral tax treaty network which can and should be developed by the OECD as a de facto global tax coordination body.

It is submitted that this irrefutable proof of the thesis hypotheses per se, establishes the theoretical basis for an MTT. This chapter will attempt to conceptualise the proposed MTT, identify key provisions of the MTT and suggest a possible process for the development and implementation of the MTT.

From 2013 to 2022, the OECD has been involved in finding solutions to stop the loss of global tax revenue through various practices, discussed in earlier chapters. Of particular relevance is the role occupied by the OECD in developing and implementing the BEPS Action Plan. This process required the OECD to conduct a vast volume of taxation-related research and to publish the results in a comprehensive series of reports from 2013 to 2022. This period of unprecedented tax-related activity resulted in the development and acceptance by a majority of tax jurisdictions of the Multilateral Instrument, an innovative protocol for the expeditious amendment of the global network of bilateral tax treaties.

Because of the unique positioning of the OECD as the repository of global tax data and the de facto global tax authority, it is the only serious contender to develop an MTT from its conceptual foundations to its acceptance by a majority of tax jurisdictions. As such, the process of conceptualising an MTT begins with an examination of the expertise in tax matters possessed by the OECD and proposes a strategic plan for the development and implementation of the MTT.

As the developer of the OECD Model tax treaty and the MLI, the OECD is extensively involved in global taxation issues. The OECD is a foundation member of the International Tax Dialogue (‘ITD’), a joint venture member of the European Commission (‘EC’), the Inter-American Development Bank (‘IDB’), the International Monetary Fund (‘IMF’), the World Bank Group, and the Inter-American Centre of Tax Administrations (‘CIAT’). The ITD aims to encourage and facilitate the discussion of tax matters among national tax officials, regional tax organisations, international organisations, and other key stakeholders.[833]

The ITD was initiated in April 2002 by the IMF, OECD, and World Bank, partly in response to the call for enhanced international dialogue on tax matters. The IDB began participating as a partner in September 2005, the EC joined in late 2008, and the CIAT shortly thereafter.

The objectives of the ITD are to:

[833] *International Tax Dialogue* (Web Page) <http://www.itdweb.org/home/>.

- promote effective international dialogue and networking between international organisations, governments, and their officials on tax policy and administration matters;
- identify and share good practices in taxation;
- work together to identify synergies and avoid duplication of already existing activities on tax matters.

This extensive involvement of the OECD in tax matters extends to the Forum on Tax Administration ('FTA'), which was created in 2002 to bring together Commissioners and tax administration officials from OECD and non-OECD countries, including all members of the G20.

While the fundamental principles upon which international tax policy is based are undergoing changes to address the consequences of globalisation and the advent of the digital economy it is undeniable that the number of rules governing the rights and obligations of taxpayers and fiscal authorities in international taxation has increased substantially over the last years, driven in particular by the outcome of the BEPS Action Plan.[834]

Of significance to the development of the MTT is the OECD-initiated general transition from bilateral to multilateral instruments with regard to tax matters. Two decades ago, the international tax world was predominantly shaped by un-coordinated domestic tax legislation and loosely connected by a network of bilateral tax treaties, most of which are based on the OECD and UN models. This has gradually changed beginning with procedural matters, for example, international exchange of information, on which the first multilateral convention was concluded in 1988.[835] More recently on 20 December 2021, the OECD published draft laws for adoption by tax jurisdictions that are intended to impose a minimum global corporate tax rate of 15% on very large MNEs. This followed work by the OECD/G20 Inclusive Framework on BEPS and had the support of 137 countries and jurisdictions, rules a significant number of tax jurisdictions have been able to agree on multilateral cooperation resulting in the adoption of the multilateral instrument adopted by Australia on 24 August 2018[836] that is hoped will provide a means to reduce loss of tax revenue through tax fraud and tax evasion. Article 6 of the Multilateral Convention on exchange of information has had the effect of making more and more items of income transparent to foreign tax authorities on an automated basis. The Common Reporting Standard, which aims for full disclosure of financial income derived by individuals, is another prominent example.[837]

[834] Schon (n 778).

[835] Ibid 13.

[836] On 24 August 2018 the *Treasury Laws Amendment (OECD Multilateral Instrument) Act 2018* (Cth) received Royal Assent.

[837] For the standardized 'template' establishing the Common Reporting Standard (CRS), see *Multilateral Competent Authority Agreement on Automatic Exchange of Financial Account Information* <http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/multilateralcompetent-authority-agreement.pdf>.

The global introduction of country-by-country reporting is another example of multilateral cooperation.[838] Under BEPS Action 13, all large MNEs are required to prepare an annual country-by-country ('CbC') report containing data on the global allocation of income, profit, taxes paid and economic activity among tax jurisdictions in which it operates.[839] Responding to pressure from governments to reduce tax avoidance by MNEs the OECD proposed the implementation of the BEPS Actions that are related to treaty issues by using a multilateral instrument . Pillars One and Two of the Inclusive Framework's work on the taxation of the digital economy will only be possible if new multilateral instruments or an MTT are employed to ensure a globally coherent application. Otherwise, the allocation of an MNE's worldwide profits to a large number of states or the application of a minimum tax rate to all subsidiaries and branches of a large firm may not be feasible.[840]

Diverging from the main issues, it is noteworthy that one major economy that appears to avoid serious involvement in global tax issues is the United States. While it shares major policies with other countries in matters of cross-border information flows and under the BEPS Action Plan, the United States has generally avoided committing to multilateral obligations. The successful migration of the global tax jurisdictions to an MTT would benefit from the support of the major economies, in particular the United States.[841]

The primary reason for developing the MTT is to combat tax fraud, tax evasion and BEPS now and in future. A MTT administered by the OECD and supported by a majority of tax jurisdictions would possess the necessary flexibility, operational strength, and simplicity of amendment to deal with future manifestations of tax evasion and tax avoidance. It is now necessary to consider the role of the OECD in the development of an MTT. The first step would require substantial jurisdictional and institutional acceptance of the OECD as the global tax authority. This initiative should come from the members of the OECD or from G20. Once the OECD has been appointed as the global taxation authority, work could commence on determining the correct model for the MTT. There have been many proposals submitted advocating different characteristics for an MTT.[842] Unfortunately, these proposals were made without access to the data available to the OECD. Furthermore, the OECD, in its role as de facto global taxation authority, is arguably the only entity that has a deep understanding of the global tax regime. It is also the only entity that has attained multilateral tax jurisdictional cooperation as referred to in this paper.

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[838] For the standardized 'template' implementing international exchange under Action 13 of the BEPS Action Plan, see *Multilateral Competent Authority Agreement on the Exchange of Country-by-Country Reports* <http://www.oecd.org/tax/automatic-exchange/about-automatic-exchange/cbcmcaa.pdf>.

[839] OECD, *Action 13 – Country-by-Country Reporting* <https://www.oecd.org/tax/beps/beps-actions/action13/>.

[840] OECD, 'Pillar One Blueprint' (n 13 and 14).

[841] Ibid.

[842] Eg, by Vann (n 4); Helminen (n 92); Ring (n 107).

The work performed by the OECD leading up to the adoption of the MLI, and the MLI per se, has laid the foundation upon which the MTT can be developed. What follows is an identification of the principal areas of tax strategy, resulting from the BEPS research and development, that should be incorporated in an MTT. The work of the OECD and others involved in the G20/OECD BEPS program and development of the MLI identified principal areas of anti-avoidance activity. It is recommended that the following four areas of anti-avoidance that were singled out as key areas of tax avoidance in the OECD Action Plan should be included in an MTT, as should a global minimum tax rate of 15%:

- neutralising the effects of hybrid mismatch arrangements
- preventing treaty abuse
- preventing the artificial avoidance of PE status
- making dispute resolution mechanisms more effective
- set a global minimum tax rate for MNEs with an annual turnover exceeding an agreed amount and including a method for annual updating of this threshold.

9.4 Conclusion

Many tax authors believe that the OECD Model has performed well throughout its tenure and that the OECD Model and individual treaties based on it can be amended by the MLI to perform their role of reducing tax avoidance in the future. Few tax practitioners would disagree with the assessment that the OECD Model has performed well until the recent advent of accelerated globalisation, the advent of the digital economy, massive high-tech corporations, cryptocurrency, the internet and so on. The outstanding problem with the OECD Model is its bilateral characteristics per se and the un-coordinated jurisdictional tax regime it has unintentionally, but predictably, facilitated.

The major deficiencies with the current tax regime, based almost exclusively on the OECD Model, have been addressed in earlier chapters. If statistics reveal that BEPS has not been reduced following the development and implementation of the MLI and the Two Pillars reform, then, arguably, a new approach is needed. The only remaining means of successfully combatting BEPS is to retire the bilateral tax treaty regime, starting with an invitation to the OECD to accept the position of global tax authority and set about the process of developing and implementing an MTT incorporating the core provisions discussed in this chapter.

This undertaking will in all probability require only a fraction of the enormous effort expended in recent years by the OECD in keeping the bilateral global tax regime, metaphorically, afloat.

CHAPTER 10: SUMMARY AND CONCLUSIONS, IMPLEMENTATION OF THE RESEARCH AND FUTURE OUTLOOK

10.1 Summary and Conclusions

This thesis has analysed the impact of globalisation and the digital economy on international tax laws, specifically as it relates to international tax avoidance, referred to as BEPS. The research is significant because the approach adopted by the OECD supports an international bilateral tax treaty regime that has been questioned by many over a lengthy period of time. The OECD has published over 30 reports on BEPS since 2013 and introduced a substantial number of anti-avoidance provisions into the realm of international taxation, with the latest anti-avoidance development, the Inclusive Framework's Two-Pillars Solution to international tax reform, released on 20 December 2021 and a Commentary to the Globe Rules published on 14 March 2022.[843] It is too early to make any assessment of the success of the Two Pillars approach. At the date of thesis completion, no data had been published to support the proposition that these anti-avoidance activities undertaken since 1988 have reduced the incidence of BEPS. The arguments presented in this thesis therefore become increasingly difficult to ignore with the passage of time.

Whilst the OECD has admitted that the incompatibility of domestic tax law and tax treaties is a cause of BEPS, the significance of the bilateral architecture of the UN and OECD model tax treaties on which the majority of tax treaties are based, has been overlooked. The gradual OECD initiated transition from bilateral to multilateral instruments arguably began in 1988 when the work undertaken by the OECD and the Council of Europe resulted in the Multilateral Convention on Mutual Administrative Assistance in Tax Matters opening for signature.[844] The adoption of a multilateral amending instrument ('MLI') in November 2016, which was supported by an overwhelming number of tax jurisdictions, casts doubt on the tax sovereignty argument commonly employed in opposition to proposals for an MTT and creates the opportunity for the advent of an MTT.[845]

The resourceful and expeditious employment of the MLI to amend the current bilateral tax treaty offers jurisdictions attempting to balance revenue depleted by BEPS with accelerating global expectations of government provision of social services an opportunity to increase their tax revenue. The current bilateral tax treaty regime has three consequential encumbrances:

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[843] OECD, *Commentary to the Globe Rules* (OECD Publishing, 14 March 2022).

[844] OECD/ Council of Europe, *Multilateral Convention on Mutual Administrative Assistance in Tax Matters*: *Amended by the 2010 Protocol* (OECD Publishing, 2010).

[845] *Multilateral Convention to Prevent BEPS* (n 322).

- The bilateral architecture per se has encouraged jurisdictions to develop their own unique domestic tax laws in isolation from those of their regional, developmental, or trading contemporaries.
- This bilateral regime, which adequately addressed the double taxation issues for which it was designed, was developed in an era when globalisation was in an early stage of development and electronic commerce did not exist. The OECD Action Plan has failed to address this fundamental flaw with the existing tax treaty regime.
- Research conducted in this thesis reveals that the MLI offends the Ottawa principles of sound tax laws in that it is arguably inefficient, uncertain, and unacceptably complicated.

International tax avoidance by MNEs has caused many to question the continued viability of the bilateral tax treaty regime in an environment in which the speed of commercial activity is ever increasing via a plethora of electronic programs and applications that enable activities, including banking via crypto currencies, to occur at the speed of light.

Although the MLI is innovative and provides a process to simultaneously amend a significant number of bilateral tax treaties, it is designed to accommodate a wide disparity of tax positions by providing a wide range of optional variations. An increasing number of participants across the global tax spectrum are questioning the viability of this model, which whilst effective for many years, is failing to adapt to current developments in international business. It is still too early to pass judgement on the MLI. With the passage of time, it will become apparent whether or not the BEPS Action Plan and the MLI have succeeded in reducing BEPS. Many believe that the most important development resulting from the OECD Action Plan is the acceptance of the OECD's reform proposals, including the MLI, by a substantial percentage of tax jurisdictions.

Arguments calling for the retention of the bilateral tax treaty regime have been based on the belief that since the bilateral regime has proved effective in the past, no major change to the global tax regime is warranted. In comparison, this thesis has taken the position that administrative considerations involved in developing and implementing an MTT should be a secondary consideration to whether it can be theoretically justified. This issue was never publicly considered by the OECD, and it may be that the OECD would prefer for this to remain obscure. Bearing this in mind, the approach taken in the thesis has been to first examine the theoretical basis for an MTT and then examine how this may be accomplished in a practical sense.

Having established a strong basis for the development of an MTT, the issue of its design should then be considered. Over many years, many various designs for an MTT have been proposed. It is highly unlikely that any entity other than the OECD has the depth of knowledge, experience, and jurisdictional respect to successfully undertake such a challenging undertaking. The successful development and implementation of the MLI gives a strong indication that the OECD is ideally placed to garner similar support for the research, design, development, and implementation of an MTT.

Consistent with this approach, two related arguments were presented in the thesis. The first argument contended that the bilateral architecture of the global tax treaty network per se, and the OECD Model on which most treaties are based and the resulting uncoordinated and individualistic domestic tax law, has permitted gaps and frictions in the global tax regime that are conducive to BEPS. This argument was first discussed in Chapter 1 and subsequently where the theoretical foundations and rationale for an MTT were analysed throughout the thesis.

Opponents of an MTT advance the principle of tax sovereignty, that may be characterised as a jurisdiction's autonomous power to positively levy taxes, as an insurmountable obstacle to an MTT. This argument may have been convincing in past eras but the active participation by over 100 tax jurisdictions in the MLI's development by the OECD is a strong indication that the principle of tax sovereignty will no longer be an impediment to the jurisdictional acceptance of an MTT. This thesis has argued and shown that the theoretical foundations and rationale that underlie the migration from the bilateral tax treaty network to an MTT remain valid in an environment in which globalisation and the digital economy will have an increasing impact on international business. In the event that the anti-avoidance measures contained in the OECD BEPS Action Plan and put into effect via the MLI fail to reduce BEPS, tax jurisdictions may demand further action, including an investigation of the prerequisites for migration from the current bilateral tax regime to an MTT.

The second argument was discussed in Chapter 8 and considered the OECD's suitability to develop an MTT. This argument will now be further developed in the context of the OECD fulfilling the extended role of a global taxation authority. The OECD was founded in 1946 and was originally known as the Organisation for European Economic Cooperation ('OEEC'). The OECD was briefly examined in Chapter 3. Since its inception in 1946, the OECD, as it is now known, has played an important role in gathering information from many jurisdictions, compiling data, and publishing valuable reports. The OECD has also functioned as a de facto global tax authority. The work performed by the OECD, in particular since 2013, has involved garnering support from a considerable number of disparate tax jurisdictions in the development and implementation of the MLI. As such, the OECD is ideally placed to bring together global tax jurisdictions in order to establish protocols for the development of the MTT.

The OECD recognises that taxation is the price of civilisation and has the power to drive development on a global scale. As such, it is by far the largest source of financing for development and enables governments to invest in relieving poverty and deliver public services to underpin long-term growth. Strong domestic resource mobilisation not only raises crucial revenues but also promotes inclusiveness, encourages good governance, improves the accountability of governments to their citizens, and cultivates social justice. By

increasing transparency and fairness, and countering corruption, national revenue systems can also improve the enabling environment for external private investment.[846]

Yet there are a number of challenges facing developing countries seeking to improve their tax systems, especially in the arena of international taxation, where international co-ordination and co-operation are needed to create robust common standards that provide both the tools and information for countries to combat tax avoidance, evasion, and financial crimes while also providing certainty and consistency for businesses.[847]

The solution to effectively countering BEPS does not lie in the volumes of reports published by the OECD in recent years, in the voluminous commentaries on the OECD model tax treaty, in the operation of the MLI, or in the coming two-pillars. The solution is to retire the bilateral tax regime and move into the future with an MTT designed and equipped to operate in current and future economic environments.

10.2 Implementation of the Research and Future Outlook

When the OECD BEPS Action Plan's anti-avoidance activities fail to substantially reduce BEPS, an MTT will become the preferred option. The issue will then be *how* to implement this outcome. Chapter 8 examined the changes to the OECD model tax treaty that have been advocated by the OECD, MLI Explanatory Statement.[848]

As the research has confirmed the validity of the two hypotheses above, two questions need to be resolved:

- Theoretically, can an MTT more effectively combat BEPS than the current bilateral tax treaty regime?
- If so, can the OECD practically develop an MTT? In this regard there are many practical and political considerations that need to be resolved in order to deliver a practically feasible solution.

If the activities recommended by the BEPS Action Plan fail to significantly reduce BEPS, then an MTT appears to be the preferred option. Chapters 1 and 2 identified many proposals for an MTT that included recommendations of processes by which an MTT could be achieved. However, the advent of the BEPS Action Plan and the multilateral instrument substantially changed the tax treaty landscape in the following manner:

- The OECD revealed the high level of expertise it possesses and established its credentials to design and implement an MTT.

[846] OECD, *What Does the Global Relations and Development Division Do?* <https://www.oecd.org/tax/tax-global/what-do-we-do.htm>.

[847] Ibid.

[848] 'Explanatory Statement' (n 7).

- The widespread acceptance of the OECD designed MLI by tax jurisdictions clearly indicated that the time for the development of an MTT may have arrived in the event that the BEPS Action plan is unsuccessful in reducing BEPS.
- The increasing level of caution displayed by tax jurisdictions towards the Two Pillars approach to the allocation of tax revenue emanating from significant global entities.

Many tax authors have previously proposed an MTT and suggested various approaches to achieve this outcome. The arguments against an MTT have generally been based on tax sovereignty and the likely opposition of a majority of tax jurisdictions to the concept of an MTT. The recent development of the MLI by the OECD, together with the general, if cautious, acceptance of the two-pillar approach, arguably relegates these proposals to a past era. The OECD have emerged as the only entity able to undertake the design and implementation of an MTT.

Attempting to Measure Base Erosion and Profit Shifting

Information on the OECD's role and functions as provided throughout this thesis presents a convincing argument for the future role of the OECD in the development of the MTT, particularly with the increasing likelihood that the OECD BEPS Action Plan will fail to substantially reduce BEPS. The reluctance of the OECD, the de facto global taxation authority, to release any data on the success or otherwise of the BEPS Action Plan creates difficulties in attempting to research the extent of base erosion and profit shifting and to base predictions for the future on that data.

Likewise, the OECD in collaboration with the other august entities referred to in this chapter is uniquely positioned to collect and analyse the data concerning international tax avoidance by multinational enterprises, called 'base erosion and profit shifting' by the OCED. It is now over two years since the multilateral instrument came into effect. This relatively short period may be insufficient to allow any conclusions to be drawn on the effectiveness of the MLI in reducing BEPS.

Continuing research will be conducted to monitor relevant data as it becomes available from all sources, including but not limited to the following:

- OECD
- UN
- World Bank
- Significant jurisdictions.

The arguments in favour of a multilateral treaty may be summarised as follows:

- The OECD and UN model tax treaties, on which the majority of bilateral tax treaties that constitute the global tax treaty regime are based, increasingly fail to keep pace with the ongoing evolution in international commerce, including globalisation, electronic commerce, crypto currencies, and

multiculturalism which together place increasing pressure on the efficacy of the existing bilateral international tax regime.

- The advent of the multilateral instrument has significantly increased the complexity and uncertainty of the role performed by the network of individual bilateral tax treaties and arguably does not comport with the principles of sound taxation policy.
- The international tax regime is becoming increasingly complicated, with fresh layers of complexity regularly experienced. The recent moves by the OECD towards multilateralism via the MLI and CbC reporting will eventually overcome political obstacles and facilitate an MTT.

10.3 Future Outlook

A preponderance of the OECD's work in recent years has been presented by the OECD as considering the tax revenue requirements of both the OECD member jurisdictions and non-member jurisdictions. It is in this context that the Global Relations and Development division delivers a varied set of programmes designed to force tax harmonisation upon jurisdictions offering low tax rates to attract mobile capital. Tax Inspectors Without Borders, Capacity Building Programmes, the Global Relations Programme, the Platform for Collaboration on Tax, the Task Force on Tax and Development and the LAC Fiscal Forum Initiative are all arguably components of the OECD tax harmonisation campaign.[849]

The ITD has delivered a global conference approximately every two years since its inception. The conferences are based on key global issues in tax and its relationship to the broader environment. These events are intended to highlight key global issues in light of broader international developments (for example, the role of tax and the environment in the context of the 21st Conference of the Parties) and add to the global state of play on certain tax issues but also introduce taxation perspectives into the wider political debate.[850]

Five global conferences have been held to date, each attended by senior officials from more than 90 countries. The conferences have focused on tax and intergovernmental relations in 2013 (Morocco), tax and inequality in 2011 (India), taxation of financial institutions in 2009 (China), small and medium enterprises in 2007 (Argentina), and value-added tax in 2005 (Italy). Six follow-up regional conferences have been held since 2009.[851]

From the publication of *Addressing Base Erosion and Profit Shifting* by the OECD in 2013 until the publication of the *Pillar Two Model Rules* on 20 December 2021, over eight years have passed, and the OECD have been unable to establish whether the huge volume of reports, recommendations and actions

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[849] Ibid.

[850] OECD, *International Tax Dialogue* (OECD Publishing, Paris).

[851] Ibid.

have reduced the incidence of BEPS. As recently as 2021, the OECD were relying on the BEPS figures of USD 100 to 240 billion per annum, first published in 2013. This enormous amount of work performed by the OECD clearly indicates that both the OECD and the 28 countries with OECD membership consider it desirable that the continuing loss of global tax revenue through BEPS is reduced or, at least, that the matter is the subject of continuing efforts in this regard.

During the 21st century, globalisation has continued to accelerate as shown by the growing number of multinational entities, the advent of digital corporations that rely exclusive or extensively on online communications technology and the advent of new banking systems, including cryptocurrencies.

Three arguments were presented in Chapter 1, and it is submitted that each of these arguments has been established by the material presented in support in this thesis. The first argument is that the bilateral architecture of the tax treaty network, based on the OECD Model and the individual domestic tax law it has encouraged, is a significant facilitator (as opposed to being an inhibitor) of BEPS. The OECD made the following statement in 2013:

> Early on it was recognised that the interaction of domestic tax systems can lead to overlaps in the exercise of taxing rights that can result in double taxation. Domestic and international rules to address double taxation, many of which originated with principles developed by the League of Nations in the 1920s, aim at addressing these overlaps so as to minimise trade distortions and impediments to sustainable economic growth. The interaction of domestic tax systems (including rules adopted in accordance with international standards to relieve double taxation), however, can also lead to gaps that provide opportunities to eliminate or significantly reduce taxation on income in a manner that is inconsistent with the policy objectives of such domestic tax rules and international standards.[852]

The second argument is that an MTT capable of reducing BEPS can and should be developed by the OECD as the de facto global tax authority. The process of stakeholder consultation could be similar to that completed by the OECD in 2015 for Action 15 of the BEPS Action Plan, referred to above. The development of an MTT as proposed raises the issue of tax multilateralism at a time when that issue dominates the international tax headlines. The overriding consideration when considering the proposal for an MTT is the requirement for international co-operation and consensus by a majority of global tax jurisdictions. The OECD's success in obtaining an agreement to develop an instrument under Action 15 supports the view that a similar development of an MTT is feasible at this time. The processes required to implement a multilateral treaty capable of replacing or co-existing with bilateral treaties are more fully addressed in Chapter 5 of the thesis. As of 25 April 2022, there is no published proof that BEPS has been reduced.

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[852] *Addressing Base Erosion and Profit Shifting* (n 23) 5.

The third argument, which follows from the preceding arguments, is that an MTT would, at least theoretically, reduce BEPS and support the fiscal policies of OECD members more effectively than the bilateral network. From a tax policy perspective, international consensus for the adoption of an MTT is central to establishing a tax regime better equipped to deal with current and future tax avoidance than the failing bilateral tax treaty regime.

Intrinsic to this research was an examination of the relevant public international law with respect to the status of the MLI. It is generally accepted that the MLI falls within the scope of a multilateral treaty. Where examinations of national laws were required, the laws of Australia were discussed. The role of the OECD as the author of various reports and other materials produced with respect to BEPS is central to the tax issues addressed in the thesis. The bilateral architecture of the current international tax treaty network, and the individual domestic tax rules it has generated, are significant facilitators (rather than inhibitors) of base erosion and profit shifting from which flows the conclusion that an MTT would, theoretically, reduce BEPS and support the fiscal policies of OECD members more effectively than the bilateral network.

An MTT designed by the OECD would theoretically receive widespread acceptance by tax jurisdictions in a similar manner to the widespread adoption of the MLI and Pillars 1 and 2 by the global tax regime. Therefore, an instrument of considerably more flexibility and certainty can, at least theoretically, be more effective in combatting base erosion and profit shifting than the current bilateral tax treaty network and should be developed by the OECD as a de facto global tax coordination body.

There has been an increasing body of support for multilateral solutions to the 'adoption of multilateral approaches to regulate taxation that can be found in the literature'.[853] Pinto argued in 2002 that in view of the world becoming 'increasingly integrated and globalised', the adoption of an international approach to tax policy should be 'self-evident'. Pinto refers to the 'reluctance on the part of countries to adopt multilateral approaches to solving emerging problems in the taxation arena'.[854] In 2002 he attributed the reluctance of countries) to two factors:

- While governmental policies, regulations and institutions tend to be nation-based, economic activity is increasingly becoming internationally-based and, therefore, a conflict is likely to occur in many policy areas, including in the area of taxation policy.[855]

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[853] Pinto, 'The Continued Application of Source-Based Taxation' (n 74) 273. Pinto refers to a report by Brian J. Arnold 'Controlled Foreign Corporation Rules, Harmful Tax Competition, and International Taxation' in Canadian Tax Foundation (ed), 2000 *World Tax Conference Report* (2000) 17:22. According to Pinto, Arnold advanced in 2000 that since business activities have become global governments must also operate multilaterally on the same global basis as businesses. Pinto also refers to a journal article by Luc Hinnekens, 'New Age International Taxation in the Digital Economy of the Global Society' (1997) 25(4) INTERTAX 116, 117 and observed that Hinnekens 'has expressed similar sentiments by observing that "[i]f the fiscal facts have become transnational, then the tax laws and institutions must also become international or operate internationally"'.

[854] Ibid 274.

[855] Ibid.

- Secondly, and perhaps most significantly in the taxation area, is the fact that national governments are reluctant to relinquish sovereignty concerning tax policy.[856]

Whilst these observations were true in 2002 times have changed and the factors referred to above may now be of considerably less significance now than in 2002. Firstly, the degree of co-operation received by the OECD from global tax jurisdictions in negotiating the multilateral tax instrument for amending the global bilateral tax treaty network, and the similar support provided for the Pillars 1 and 2 proposals for global taxation of large MNEs cast doubt on the accuracy of these obstacles at this time.

The OECD has devoted considerable effort over the past nine years in attempting to reduce international tax avoidance, also known as BEPS. The role of the OECD is best described by the OECD itself:

> The Organisation for Economic Co-operation and Development (OECD) is an international organisation that works to build better policies for better lives. Our goal is to shape policies that foster prosperity, equality, opportunity, and well-being for all. We draw on 60 years of experience and insights to better prepare the world of tomorrow.
>
> Together with governments, policy makers and citizens, we work on establishing evidence-based international standards and finding solutions to a range of social, economic, and environmental challenges. From improving economic performance and creating jobs to fostering strong education and fighting international tax evasion, we provide a unique forum and knowledge hub for data and analysis, exchange of experiences, best-practice sharing, and advice on public policies and international standard-setting.[857]

Mathias Cormann the current OECD Secretary-General says of the OECD:

> The OECD is a force for good in the world. All of us have a collective responsibility to use it to its full potential. Our core purpose, under our Convention, is to preserve individual liberty and to increase the economic and social well-being of our people. Our essential mission of the past – to promote stronger, cleaner, fairer economic growth and to raise employment and living standards – remains the critically important mission for the future.

The achievement by the OECD in gaining widespread acceptance by tax institutions of the MLI and Two Pillars proposals confirms the argument expressed in this thesis that the OECD is the only organisation possessing the political skills to administer a global tax authority. In 1996, Vito Tanzi argued that the role of the OECD probably falls short at the political level, as it is principally concerned with the diffusion of information and the discussion of technical issues rather than having any real decision-making power and binding authority and control over its Member nations.[858] Whilst this may have been a reasonable

[856] Ibid.

[857] 'Who We Are', *OECD* (Web Page) https://www.oecd.org/about/.

[858] Pinto, 'The Continued Application of Source-Based Taxation' (n 74) 275, referring to Vito Tanzi, *Taxation in an Integrating World* (1996) xi (observing that 'increasing economic integration among nations will continue to erode differences among national economies and undermine the autonomy of national governments').

assumption in 1996, events of the past nine years confirm that the role of the OECD has expanded from that of an advisor on international tax to that of de facto global tax administrator.

Further analysis of the role of a global tax authority is beyond the scope of this thesis. The acceptance by the OECD of the role of global tax authority and the simultaneous acceptance to develop an MTT in consultation with all tax jurisdictions willing to participate in that undertaking is theoretically, and logically, the next step in opposing BEPS.

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