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by

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ABSTRACT

Unprecedented attention to aggressive international tax planning has shaken the earth under the most powerful players in the world of international tax policy design. The media exposure of what Bloomberg's calls "The Great Corporate Tax Dodge," combined with the ever-growing discontent of civil society with the magnitude of contribution of the largest multinational enterprises to the society within which they operate, has recently forced the politicians to take action. Leaders of the strongest world economies demanded a revision of the rules of the international tax regime that would generate more revenues for their challenged coffers and would restore public trust in the system. In what is now commonly known as the Base Erosion and Profit Sharing ("BEPS") project, the OECD has established three principles: (1) promotion of collaborative rather than competition based solutions; (2) take a holistic view of the challenges and their corresponding solutions rather than an ad hoc approach; and (3) permit the consideration of innovative solutions even when they conflict with the traditional premises of the current international tax regime. This Article reviews the progress of the BEPS project and its compatibility with the fundamental principles for reform set by the OECD with a view to influence the discourse and the outcome of the project. This Article focuses on the importance of the paradigm shift from the current emphasis on competitiveness and the perfection of competition to a collaborative international tax regime, demonstrating the desirability of such a shift and suggesting how the OECD should go about making that shift.

* University of Florida Research Foundation Professor, University of Florida, Levin College of Law. I thank Professor Robert Danon and the participants in the Swiss "Rethinking Corporate Tax Policy" conference at the University of Lausanne for their insightful comments. I also thank the Max Planck Institute for Tax Law and Public Finance, particularly its director Professor Wolfgang Schön, for the kind research support. All mistakes and inaccuracies are mine.

I. INTRODUCTION

"What the BEPS are we talking about?" Ask officials from the Organisation for Economic Co-operation and Development ("OECD")

charged with responding to the global outrage over Base Erosion and Profits Shifting ("BEPS") by mega multinational enterprises ("MNEs").[1] "It is 'The Great Corporate Tax Dodge,'"[2] Bloomberg and other media networks answer, generating an unprecedented hype over international tax law and exposing the apparently very successful and allegedly permissible tax planning techniques of the largest United States MNEs.[3] But the OECD correctly asserts that BEPS is not a new phenomenon, citing President Kennedy's concerns about much the same phenomenon in 1961.[4] Indeed, there is nothing substantively new about BEPS, yet globalization and the evolution of the international tax regime have created the conditions for MNEs to maximize their inherent advantages in tax planning,[5] and the MNEs have taken full advantage of these conditions. They perhaps have crossed the line beyond which these advantages became obviously visible and thus publicly objectionable.

Thus, the substantive rules of the international tax regime were beside the point; it was the media exposure of these tax-planning schemes that mattered. This exposure spilled over beyond the United States to other countries and, at the same time, triggered political interest in and questioning

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1. Pascal Saint-Amans & Raffaele Russo, *What the BEPS Are We Talking About?*, OECD, http://www.oecd.org/ctp/what-the-beps-are-we-talking-about.htm (last visited Mar. 24, 2014) [hereinafter Saint-Amans & Russo, *What the Beps*?].

2. *The Great Corporate Tax Dodge*, BLOOMBERG, http://topics.bloomberg.com/the-great-corporate-tax-dodge/ (last visited Mar. 20, 2014).

3. Initially, the tax planning schemes of the largest technology corporations such as Apple, Microsoft, and Google were exposed. *See, e.g.*, Charles Duhigg & David Kocieniewski, *How Apple Sidesteps Billions in Taxes*, N.Y. TIMES (Apr. 28, 2012), http://www.nytimes.com/2012/04/29/business/apples-tax-strategy-aims-at-low-tax-states-and-nations.html?_r=0; Jesse Drucker, *Google Revenues Sheltered in No-Tax Bermuda Soar to $10 Billion*, BLOOMBERG (Dec. 10, 2012), http://www.bloomberg.com/news/2012-12-10/google-revenues-sheltered-in-no-tax-bermuda-soar-to-10-billion.html; Richard Waters, *Microsoft's Foreign Tax Planning Under Scrutiny*, FINANCIAL TIMES (June 7, 2011), http://www.ft.com/cms/s/2/0880cd54-90a1-11e0-9531-00144feab49a.html#axzz2sl7hvIaz. Soon thereafter, however, it became clear that the phenomenon is more widespread. *See, e.g.*, Edward D. Kleinbard, *Through a Latte, Darkly: Starbucks's Stateless Income Planning*, 139 TAX NOTES 1515 (June 24, 2013).

4. Saint-Amans & Russo, *What the Beps*?, *supra* note 1.

5. These advantages include the obvious opportunities to engage in tax rates and rules arbitrage and the ability to take advantage of the range of acceptable transfer prices. *See, e.g.*, Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 VA. TAX REV. 79, 161–62 (2008) [hereinafter Brauner, *Value*] (explaining that the transfer pricing rules produce a range of acceptable prices; such range is available only to MNEs—and more so to intangible-extensive MNEs—to minimize their effective taxation unrelated to other tax planning).

of these practices.[6] A perfect storm broke out, exacerbated by the world economic downturn and the need of revenue that did not skip even the richest economies. The G20, with some of the discussion supplemented by similar discourses in other fora,[7] demanded action and charged the OECD with finding solutions to BEPS.[8] The OECD—the reluctant caretaker of the international tax regime—was required to solve the very problems it had faced for a long time. Now, however, it has a deadline—one that is perhaps uncomfortably short.[9]

The first goal of this Article is to evaluate the work done by the OECD on BEPS to date,[10] asking: What the BEPS are they doing? This Article first identifies three distinct, yet interdependable, core principles established by the BEPS project as fundamental for international tax reform: (I) the necessity of establishing the international tax regime on a collaborative-based paradigm rather than a competition-based paradigm; (II) the importance of taking a systematic or holistic approach to substantive international tax reform rather than an ad-hoc approach, acknowledging the interdependence of the norms of the international tax regime; and (III) the inevitability of accepting completely new solutions to problems that could not be resolved by the applicable norms, contrary to the traditional

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6. *See, e.g.*, *Offshore Profit Shifting and the U.S. Tax Code - Part 2 (Apple Inc.): Hearing Before the Permanent Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Governmental Affairs*, 113th Cong. (2013).

7. One such discussion forum was the G8. Prime Minister's Office & Cabinet Office, *G8 factsheet: tax*, GOV.UK (June 7, 2013), https://www.gov.uk/government/publications/g8-factsheet-tax/g8-factsheet-tax.

8. G20, *G20 Leaders Declaration*, at ¶ 48, G20 at Los Cabos, Mexico (June 18–19, 2012), https://www.g20.org/sites/default/files/g20_resources/library/G20_Leaders_Declaration_Final_Los_Cabos.pdf.

9. The tax community should expect finalization of a large set of measures by early 2014. *See* Webcast: *BEPS Action Plan: Update on 2014 Deliverables*, OECD (Jan. 23, 2014), http://www.oecd.org/tax/beps-webcasts.htm [hereinafter OECD, *BEPS Action Plan*]. Therefore, the window of opportunity to inform the discourse is at the present open, but limited.

10. The OECD produced an initial report on February 12, 2013, "Addressing Base Erosion and Profit Shifting," followed by an action plan that dictated delivery of a wide set of measures by two primary deadlines, September 2014 and September 2015. There is also a December 2015 deadline for some aspects of the interest expense action item 4, harmful tax practices (action item 5) and the multilateral instrument action item 15. *See* OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING (2013), http://www.keepeek.com/Digital-Asset-Mangement/oecd/taxation/addressing-base-erosion-and-profit-shifting_9789264192744-en#page1[hereinafter OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING]; OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING (2013), http://www.oecd.org/ctp/BEPSActionPlan.pdf [hereinafter OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING].

conservatism of the international tax regime. This Article then evaluates the action plan set by the OECD, the various follow-up actions, and the public and private speeches by OECD officials regarding potential conclusions of the BEPS project in light of the abovementioned principles. The goal of this evaluation, even if partly based on educated speculation regarding future action, is to influence the outcome of the project while the window of opportunity to do so is still open. This Article views the fundamental principles of the BEPS project as desirable and instructive and it critically exposes the instances in which it identifies that the OECD may deviate from those principles.

The second goal of this Article is to expose, through the analysis of the BEPS project, the failings of the current competition-based paradigm of the international tax regime and to demonstrate the desirability of a shift of paradigm towards a more collaborative regime based on cooperation and coordination of tax policies. BEPS and the corporate tax planning schemes that have enraged the ailing world economies are a direct result of this current international tax regime[11] that is characterized first and foremost by competition for investment and revenue among countries. Ricardian trade theory led the world powers in the beginning of the last century to agree on some regulation of this competition. Standardization and reciprocity were thought to enhance competition and thus to improve efficiency and growth potential. As a result, standard setting has been acceptable, especially when led by the rich countries' club—the OECD. Yet the primary building block of the regime has always been domestic law, unilaterally enacted and implemented, even if subject to limitations imposed by the rather weak norms of the international tax regime woven together by bilateral tax treaties.

The BEPS project's most fundamental insight to date has been noting the failure of this paradigm. Countries, even those with the strongest economies, are not powerful enough to satisfactorily enforce their tax laws pursuant to the current regime. By definition, unilateral action, regardless of its substance, cannot succeed, and consequently, international coordination of tax policies is required as a condition for any chance to implement substantial reform. Implementing this insight into an international tax reform would be an immense achievement. The OECD has already jumpstarted the process and now has an opportunity to make progress toward this goal. This

11. *See, e.g.*, Reuven S. Avi-Yonah, *Commentary*, 53 TAX L. REV. 167, 169 (1999) [hereinafter Avi-Yonah, *Commentary*] (explaining that the regime is constructed around the network of bilateral tax treaties, essentially all of which are modeled after the OECD Model Tax Convention). The original acknowledgment of the existence of such a regime was in Reuven S. Avi-Yonah's "The Structure of International Taxation: A Proposal for Simplification." Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301 (1996) [hereinafter Avi-Yonah, *A Proposal for Simplification*].

Article wishes to support the OECD so that it does not get distracted and resort to the old habits specifically identified as ineffective by the BEPS project.

The BEPS project is not merely a populist sensation. Some may try to diminish its importance, arguing that the media exposure and the political interest are likely to disappear when the next story emerges. Others may argue that BEPS is not significant enough to cause concern and, in any event, may not be all that harmful. Alternatively, they may argue that governments who support "their" firms competing on the market soberly permit BEPS. Such governments have the ability and sufficient information to change course, yet they choose not to do so in the name of so-called international competitiveness. Contrary to this line of argumentation, this Article argues that the BEPS project is important and requires tax technical and policy attention. It reasons that while the political demand of action does not go away, it is obviously more desirable to advance the international tax regime rather than harm it. The OECD must do "something;" it is the responsibility of the international tax community to make an effort and to ensure that the outcome is positive. The tight timeline is particularly worrisome in that regard. A key tactical concern is that the haste would trigger popular, ad-hoc partial solutions based on an already existing arsenal of measures rather than comprehensive and principled rethinking of the yet-to-be-beaten challenges. That would be per se undesirable and a waste of the political will to reform the international tax regime, when such political will is usually an obstacle for progress in the field.

The BEPS project is also important because reform is substantively necessary. The alleged modest magnitude of BEPS, especially when observed in light of the relatively small amount of revenue involved and the alternative tax planning techniques otherwise available to MNEs, supported a cynical view of the project. Nonetheless, although the empirical research of BEPS is not as extensive and comprehensive as one would expect, and the relevant data available clearly leaves something to be desired, they are significant enough to trigger action.[12] One should add to the benefits of action the opportunity to improve not only the more-limited BEPS-negating consequences, but also the international tax regime in general.

The third goal of this Article is to insert into the discourse an element that is often missing, yet is at its core: the legitimacy and stability of the international tax regime. This should not be ignored in these times of crisis and of opportunity. Cooperation among countries on BEPS-negating measures may, and should, serve as an example for cooperation and

12. *See, e.g.*, Clemens Fuest, Christoph Spengel, Katharina Finke, Jost H. Heckemeyer & Hannah Nusser, *Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform*, 5 WORLD TAX J. 307, 314–16 (2013) (reviewing literature and assessments of the question).

coordination of tax policies more generally. Involvement of civil society and general transparency could go a long way toward progress. It also should have the benefit of support from governments confronted by political pressure from business. In this regard, it would be a mistake to limit the importance of the BEPS project to the "OECD world." All productive countries suffer the consequences of BEPS, and, consequently, all the less-productive countries may find themselves as the targets of at least some of the proposed measures to combat BEPS.

Part II of this Article provides an exposition of the competition-based character of the current international tax regime and its consequential failings and the opportunities presented by policy coordination. Part III follows with an analysis of the OECD's action plan and evaluates the plan in light of the fundamental principles for reform set by the project. Part IV concludes with a normative assessment of the BEPS project as an opportunity for an unprecedented international tax reform that would give the ailing international tax regime the chance for recovery to the benefit of all.

II. OUR COMPETITION-BASED INTERNATIONAL TAX REGIME

To understand the insight of the BEPS project regarding the inevitability of collaboration among countries on tax matters, one must first understand the current international tax regime that has, on principle, been resisting cooperation and coordination of tax policies. This Part begins with an explanation of current policies; it then proceeds to explore the challenges that these competition-based policies have faced; and finally, it explains what cooperation means in this context and how countries may go about reforming the international tax regime to accommodate a cooperative approach.

A. The Rise of the International Tax Regime

The current international tax regime is constructed from a large network of (mostly) bilateral tax treaties—some 3000 of them.[13] These treaties regulate the tax consequences of a very large portion of world trade and investment, often estimated at 85 percent. The overwhelming majority of these treaties conform to a single model convention that has evolved over the years to the current 2010 OECD model.[14] It is estimated further that about 75

13. *See* Avi-Yonah, *Commentary*, *supra* note 11; Avi-Yonah, *A Proposal for Simplification*, *supra* note 11; REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME 2–4 (2007) [hereinafter AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW].

14. The 2010 OECD model has evolved over the years from the initial 1963 OECD draft model. The latter continued the tax treaty project originally initiated by

percent of the language of all bilateral tax treaties is identical to the language of the OECD model.[15] Yet, even beyond that, the OECD has clearly been successful in standardizing the international tax discourse and dominating its evolution in the last half-century. Tax treaties and domestic tax laws have clearly converged, often in the direction of conformity with the norms promoted by the OECD. International tax professionals all speak the same "language," and essentially all divergences from the standard norms are expected and familiar to those educated in the field.

Divergences, of course, do exist. The international tax regime has not yet evolved into a supranational norm although some have suggested that it is close—perhaps at the verge of being considered customary international law.[16] This suggestion, however, is probably outside the consensus. Nonetheless, until recently it was clear that the strong trend was of rule convergence and of increasing power accumulation by the OECD as the caretaker of the international tax regime. The OECD has shown ambivalence about its caretaker role, however. On one hand the OECD has worked on increasing its power and influence worldwide, primarily through the promotion of standardization and convergence; yet, on the other hand it always has been and has viewed itself as the representative of the interests of its members—the club of the rich countries. As such, it perhaps viewed itself unauthorized to consider interests of other countries, at least to the extent they conflict with its members' interests. At the same time, no other institution came close to being a candidate for leading—or even hosting—a global international tax discourse.[17] Consequently, the current international

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the League of Nations in the 1920s. *See, e.g.*, PHILIP BAKER, DOUBLE TAXATION CONVENTIONS intro. § A (Sweet & Maxwell eds., 2013) (providing a brief review of the history of the OECD model).

15. *See, e.g.*, Reuven S. Avi-Yonah, *Double Tax Treaties: An Introduction* (Dec. 3, 2007) (unpublished manuscript), SSRN: http://ssrn.com/abstract=1048441.

16. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW, *supra* note 13, at 3–5.

17. The United Nations abandoned its tax project after WWII, and has only recently resumed the work in the area, yet even then in a limited capacity and explicitly not in competition with the OECD. This recent work is demonstrated on the website of the new section for international cooperation in tax matters within the U.N.'s Financing for Development division. *See, e.g.*, *Committee of Experts on International Cooperation in Tax Matters*, FINANCING FOR DEV., http://www.un.org/esa/ffd/tax/ (last visited Mar. 29, 2014). Another proposed candidate was the WTO. *See, e.g.*, Joel Slemrod & Reuven Avi-Yonah, *(How) Should Trade Agreements Deal With Income Tax Issues?*, 55 TAX L. REV. 533 (2002). *But see, e.g.*, Yariv Brauner, *An International Tax Regime in Crystallization*, 56 TAX L. REV. 259 (2003) [hereinafter Brauner, *Crystallization*] (dismissing the WTO's capability of serving as the caretaker of the international tax regime due to its lack of tradition and expertise on tax matters, and due to its already existing political difficulties of managing its traditional international regulatory fields, such as investment, IP, agriculture, etc.).

tax regime has crystallized in an evolutionary manner, with no clear forum or global leadership. Naturally, the interests of the stronger economies have dominated the regime. The typical manifestation of this increasing dominance was the trend toward more residence-based taxation at the expense of source taxation, as promoted by the OECD.

B. The Fall of the International Tax Regime?

This picture of global dominance over the international tax rules by the OECD and its rich members has altered in recent years. Globalization and the now well-known changes in the power map around the world dictated this change. The strongest OECD economies, including Germany, the U.K., France, Japan, and, most of all, the former superpower—the United States—have lost significant clout. Former struggling economies, such as the BRICS countries, have emerged and learned that they are able to leverage their new power. At the same time, MNEs have gained power at the expense of nation-states—primarily at the expense of their own rich countries of residence. These developments shook the international tax regime, leading some to suspect its demise.[18] Such demise manifested itself primarily in two developments.

First, the emerging economies—particularly China, India, and Brazil—have taken a more active role in the shaping of the international tax regime, despite not being OECD members.[19] This has resulted in a reversal of the trend towards maximizing residence taxation mentioned above. Recent years have been marked by the OECD's attempts to increasingly permit source taxation.[20] There is some controversy over the exact drivers,

18. *See, e.g.*, Philip Baker, *Is There a Cure for BEPS?*, 5 BRIT. TAX REV. 605, 606 (2013) (arguing that the OECD's continuing dominance over the international tax regime seriously depends on its success of delivering meaningful reform, by consensus, through the BEPS project).

19. China and India have done this primarily through vocal participation as observers in OECD proceedings, and Brazil through an adoption of a norm decidedly different and often explicitly rejected by the OECD. *See, e.g.*, Yariv Brauner & Pasquale Pistone, Eds., BRICS AND THE INTERNATIONAL TAX REGIME (IBFD, forthcoming 2014) [hereinafter Brauner & Pistone, BRICS] (exposing the opposition presented by the BRICS countries to the OECD and its model tax convention and assessing the future of the international tax regime in light of the decrease of power among OECD members and increase of power of non-OECD member countries).

20. The most notable example for this trend is the acceptance by the OECD of the notion of service PE, permitting taxation by the source country of income related to mere service provision even in the absence of a "permanent establishment" in the traditional sense. *See, e.g.*, OECD, Commentary on the Model Tax Convention art. 5, ¶ 4 (2010) [hereinafter OECD, Commentary].

motivations, and magnitude of this reversal of trend, yet there should be little debate about its direction and the importance of the actions by the abovementioned countries to effectuate it. Naturally, such a change in course reduced the level of convergence and standardization within the international tax regime.

Second, nation-states as a whole—and the richest nations in particular—have lost power and simultaneously to the rise of their own MNEs, some of which have gained power and riches beyond those of many countries.[21] Globalization significantly increased the mobility and potential profitability of MNEs, and thus reduced much of their dependence on their countries of residence. The legal framework and the lack of coordination among countries further permitted these MNEs—as explained below—to also avoid some of the regulatory power imposed by countries, including their taxpaying obligations. The international tax regime has proven incapable of stopping them, as asserted by the BEPS project.

Consequently, countries in general face a revenue crisis. Developed countries, although still the most powerful countries, suffer most of all in relative terms because they have been hit hardest by the global financial crisis; they have the most to lose from the shift of global economic power; they are expected more than most to finance expensive programs (particularly the welfare state); and, being democratic, they are the most politically fragile and the least nimble. Emerging economies suffer less—perhaps because they are growing—yet they too are losing power to MNEs, and they too have begun to deal with civil society pressure of the kind reserved for the developed countries that they are becoming. Finally, the developing world unquestionably suffers because it did not have a voice in the first place, and it is unlikely that it will have any say at all when at odds with MNEs that are politically and financially more powerful. This general threat on countries of all kinds serves as a common ground to incentivize international action on corporate taxation in general and BEPS in particular. Unfortunately, such collective action is contrary to the current properties of the international tax regime, as explained next by this Article.

C. Tax Competition

The international tax regime is—and has always been—first and foremost about competition. Countries view themselves as competitors for investment and revenue. Collaborative action among countries is limited to

21. *See, e.g.*, *Companies Richer than Countries in UN List*, THE SCOTSMAN (Aug. 13, 2002), http://www.scotsman.com/business/economy/companies-richer-than-countries-in-un-list-1-616810 (reporting on data and discussion of this phenomenon in the 2002 World Summit in South Africa).

perfecting competition, accomplished through the removal of market failures and facilitation of free trade.[22] These were the motivations for the construction of the international tax regime and for its evolution over the years. The original regime was designed for immobile income production by brick-and-mortar economies. Thus, it is based on the residence and source paradigm. All countries essentially tax their residents—their people that cannot go elsewhere—on a residence base and tax foreigners with physical presence within the countries' territory on such physical presence, hence source base. The increasing mobility of labor and capital, coupled with the ascent of intangible assets, left this paradigm unfitting. As demonstrated by Avi-Yonah, neither the developed nor the developing countries are now able to collect much revenue based on this paradigm.[23]

Yet, this paradigm continues to dominate the international tax regime because of the inability of countries to cooperate and coordinate their policies. Residence countries assert their power to increase residence taxation that they still believe they can collect at the expense of source taxation. Source jurisdictions resort to tax concessions; they understand that they have lost the ability to tax, so they attempt to make sure that at least they can preserve investment in their country, hoping, usually unwisely, to benefit from its other positive spillover even if it does not directly generate revenue at the short-term.[24] The newly strong source jurisdictions, such as India, attempt also to reverse the trend and collect some source taxation at the expense of the residence countries.[25]

Thus, despite the impressive convergence of norms and standardization manifested in the international tax regime, it is a competitive, beggar-thy-neighbor approach that has been guiding the norms themselves.

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22. *See, e.g.*, Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 GEO. L.J. 543 (2001) [hereinafter Roin, *Competition and Evasion*] (arguing that harmonization efforts, like all cartelization attempts, are bound to fail and advocating constructive, rather than destructive, competition). For a recent review of the economic literature on the subject, see Michael Keen & Kai A. Konrad, *The Theory of International Tax Competition and Coordination* (Max Planck Inst. for Tax Law and Pub. Fin., Working Paper No. 2012-06, 2012), http://ssrn.com/abstract=2111895.

23. See Reuven S. Avi-Yonah, Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State, 113 HARV. L. REV. 1573 (2000).

24. *See, e.g.*, Yariv Brauner, *The Future of Tax Incentives*, *in* TAX LAW AND DEVELOPMENT 25 (Brauner & Stewart eds., 2013) (explaining that tax incentives tell a story of tax competition that compels source jurisdiction to grant such incentives although they understand that they are not effective growth triggers).

25. For a review of these developments see, for example, D.P. Sengupta, *India Chapter*, *in* Brauner & Pistone, BRICS, *supra* note 19.

D. Competition and Coordination

The tax competition debate has often been framed as a competition versus harmonization contest. Supporters of tax competition are primarily responsible for this framing and the frequent all-or-nothing analysis that typically leads to preference for more tax competition.[26] Discomfort about a global tax government and disbelief in the ability of countries to agree on all matters important for international taxation led to immediate dismissal of any alternative to the tax competition paradigm without a serious study and consideration of its benefits.

Failures of the competition paradigm have not discouraged its proponents, as they have continued to advocate further perfection of the competition again and again with little success.[27] The undesirable aspects of tax competition are merely tagged as "harmful tax competition" and rogue players—tax havens—were handled by invitation to subscribe to the rules of the (competition) game,[28] or to abide by a "code of conduct,"[29] rather than by exclusion. All such action has clearly failed to date.[30]

This Article demonstrates that there is a risk that the BEPS project will follow the same path and methods and will therefore likely fail if it does not adopt a new approach. To do that, the OECD should acknowledge that collective action of some sort is necessary, and the only aspect in question is the extent of coordination desirable rather than a clear choice between cooperation and competition.

Current rules are largely characterized by a similar binary choice—a preference for source or residence taxation. Only one country between the two involved "wins."[31] In general, sharing or apportionment is not acceptable. The one occasion where the rules divert from this paradigm is in the conventional tax treaty limitations on source countries' withholding tax

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26. *See, e.g.*, Roin, *Competition and Evasion*, *supra* note 22.

27. Demonstrated best by OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING, *supra* note 10.

28. *See, e.g.*, OECD, HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE (1998), http://www.oecd.org/tax/transparency/44430243.pdf.

29. *See Harmful Tax Competition*, EUROPEAN COMMISSION, http://ec.europa.eu/taxation_customs/taxation/company_tax/harmful_tax_practices/ (last visited Mar. 29, 2014).

30. The OECD has even discontinued the maintenance of its Harmful Tax Competition website. For a more optimistic view of the campaign, yet one that includes a fair, and not so favorable, evaluation of it, see Reuven S. Avi-Yonah, *The OECD Harmful Tax Competition Report: A Tenth Anniversary Retrospective*, 34 BROOK. J. INT'L L. 783 (2009), http://ssrn.com/abstract=1194942 [hereinafter Avi-Yonah, *Harmful Tax Competition Report*].

31. *See, e.g.*, articles 7, 8, and 13 of most tax treaties, following the corresponding articles of the 2010 OECD Model.

rates on dividends, interest, and royalties.[32] These rules permit source taxation, yet they do not grant a total taxing power to the source countries as they do in all other cases; rather, they limit the source countries' taxing power to an acceptable portion, leaving the rest to the residence country. This sole deviation from the all-or-nothing norm is, however, rather limited and is being constantly decimated. First, the clear trend led by the OECD has been to eliminate withholding taxes. The OECD has effectively eliminated the source countries' portion of taxing interest and royalties, leaving only dividends subject to this unique construct.[33] Yet many OECD countries push further in the direction of reducing withholding taxes to zero—even on dividends.[34] Many other countries do not tax dividends at source, and others exempt them at residence.[35] These trends leave a pretty limited role for this exception to the clear binary nature of the norms of the international tax regime in the general scheme of this regime; the design of the rules demonstrates the competition paradigm that is at its heart. This paradigm has led to the current deficit in the ability of countries to collect taxes. This Article argues that this deficit is not unavoidable. The solution is in cooperation among countries to make sure that they all enjoy at least some—preferably fair—revenue raising potential. This will be possible if apportionment and sharing that have been avoided in the past are embraced by the international tax regime.

E. Coordination

Cooperation and coordination of tax policies do not require complete, or even partial, harmonization of the international tax rules, although the latter may be—unrelatedly—desirable.[36] They simply permit allocation of taxing rights in a manner that is different from that of the current all-or-nothing rules. Take, for example, a simple yet common scenario: A customer in country A calls for paid computer support in country B. Both A and B have here a reasonable taxing claim. Current rules call for a decision to be made: Where is the source of the service income at question?

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32. *E.g.*, articles 10–12 of tax treaties, following the 2010 OECD Model.

33. *Id.*

34. Led by the United States. *See, e.g.*, Linda L. Ng, *World Tax Advisor: Japan-US Treaty Protocol Sets New Gold Standard*, DELOITTE (Feb. 22, 2013), http://newsletters.usdbriefs.com/2013/Tax/WTA/130222_1.html (describing the adoption of this rule in the most recent treaty renegotiation by the United States).

35. *See, e.g.*, Carlo Garbarino, *Taxation of EU Cross-Border Corporate Dividends: Convergence and Tax Competition* (Bocconi Legal Studies, Research Paper No. 2298085, 2013), http://ssrn.com/abstract=2298085 (a recent review of these developments in EU countries).

36. *See, e.g.*, Brauner, *Crystallization*, *supra* note 17 (advocating a gradual and partial harmonization of the international tax rules).

In the brick-and-mortar economy this was generally an easy question that everybody answered quite similarly. Yet, in the above scenario, country A uses an analogy to low-tech services and views the source as the place where the service provider is located, that is, country A, whereas country B may view it based on an economic analysis in country B. There is no right or wrong here, no economically or morally correct answer. In fact, source has never been about moral or economic correctness, but rather about legitimacy and practicality: it was viewed as fair and hence acceptable that the source country gets to tax income generated by an effort made within its jurisdiction. Legitimacy and acceptance may be preserved if both source and residence countries viewed a solution as fair. Logic requires here a split of the tax base between the competing jurisdictions; it does not matter what split—fifty-fifty or otherwise—because it is the principle that is being debated.

The problem with a split is that it would be difficult to gather sufficient support for a split norm that would not be based on some pseudo-economical or otherwise justification unless an admittedly unreasonable and unlikely Solomonian fifty-fifty default rule is administered. But, we already said that such justifications do not really exist. Consequently, a split could only be reached by agreement rather than by an external rule. A default external rule may make reaching an agreement simpler, though. Moreover, circumstances change, so such an agreement must be crafted in a sophisticated way to give it a dynamic ability to adapt to changes in circumstances. The above simple example could in fact be resolved in a simple manner of fifty-fifty or otherwise, yet more-complex situations require more-complex solutions, and necessarily more-complex agreements. These agreements may be based on economic indicators, such as the effort involved, capital spent, etc. Yet, they cannot follow a singular "truth" that simply does not exist. One can easily detect that the above analysis demonstrates the need for a shift from the current source and residence paradigm to a regime that is based on more formulary elements if the international tax regime is to survive. Although this Article reverts to this observation in the conclusion, next it analyzes the OECD BEPS project in light of the project's insights explained above and the understanding established here that competition and unilateral action have led to the current crisis and that only coordination could resolve it.

III. THE OECD ACTION PLAN

This Part analyzes the OECD's BEPS action plan, together with the actions and statements by OECD and other country officials pertaining to the plan, for its compatibility with the fundamental principles of the BEPS project. More specifically, this Part evaluates to what extent do the above actions and statements reflect a change of paradigm toward a more

collaborative international tax regime of the sort explained in Part II. It further assesses whether these actions and statements truly reflect a holistic approach to international tax reform and openness to including innovative mechanisms in such reform.

The action plan itself is by now well known. It includes 15 action items with deadlines for deliverables on September 15, 2014 or 2015, with a few residual issues scheduled for December 2015.[37] The action items are a potpourri of issues and reflect the opportunistic and unprincipled upbringing of the BEPS project. Nonetheless, one could identify five topical groups of action items. First, there are the more-general, overarching action items that represent some ongoing challenges to the international tax regime. This group includes action items one ("Address the Tax Challenges of the Digital Economy") and five ("Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance"). A second group includes the perhaps "true" action items: substantive norms, which had their vulnerability exposed by BEPS and which require technical revision to address these challenges. These are action items two ("Neutralise the Effects of Hybrid Mismatch Arrangements"), three ("Strengthen CFC Rules"), four ("Limit Base Erosion via Interest Deductions and Other Financial Payments"), six ("Prevent Treaty Abuse"), and seven ("Prevent the Artificial Avoidance of PE Status"). This group should include the transfer pricing regime as well, yet due to that regime's centrality to both the threat presented by BEPS and to the BEPS project itself, this Part discusses it separately in a third group that includes action items eight through 10 ("Assure that Transfer Pricing Outcomes Are in Line with Value Creation") and 13 ("Re-examine Transfer Pricing Documentation"). A fourth group includes the supporting cast, a set of action items dealing with administrative and compliance issues. These are action items 11 ("Establish Methodologies to Collect and Analyse Data on BEPS and the Actions to Address It"), 12 ("Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements"), and 14 ("Make Dispute Resolution Mechanisms More Effective"). Finally, this Part separately discusses action item 15—which explores the possibility of developing a multilateral instrument—because it is the direct manifestation of the key insight of the BEPS project: promoting the necessity of a universal, collaborative international tax regime.

A. The General Challenges

The general, overarching challenges addressed by the action plan represent two different aspects of the effect of globalization on the international tax regime.

37. *See* OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10.

1. Action Item 1 ("Address the Tax Challenges of the Digital Economy")

The current international tax rules were not designed for the new digital economy.[38] They attempted to adapt to technological progress and the ascent in importance of value created by intangibles, especially in the cross-border context. Yet, they were merely tweaked[39]—apparently unsatisfactorily—to fit these changes.[40] Therefore, the need arose to:

> Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and

38. *See, e.g.*, Chang Hee Lee, *Impact of E-Commerce on Allocation of Tax Revenue Between Developed and Developing Countries*, 4 J. OF KOREAN L. 19, 21 (2004) ("[D]igital technology completely destroys the economic and legal basis for the existing rules of international taxation, implying the necessity of a complete overhaul . . . .").

39. *See, e.g.*, OECD, ARE THE CURRENT TREATY RULES FOR TAXING BUSINESS PROFITS APPROPRIATE FOR E-COMMERCE?, FINAL REPORT (2004), http://www.oecd.org/tax/treaties/35869032.pdf [hereinafter OECD, TAXING BUSINESS PROFITS]; OECD, E-COMMERCE: TRANSFER PRICING AND BUSINESS PROFITS TAXATION, TAX POLICY STUDIES NO. 10 (2005), http://www.biac.org/members/tax/BEPS/E-Commerce_Transfer_Pricing_and_Business_Profits_Taxation.pdf. The most significant outcome of this work was the changes to Article 5 in the OECD Commentary, resulting in the addition of paragraphs 42.1–42.10.

40. This is evidenced by the OECD's identifying the "[a]pplication of treaty concepts to profits derived from the delivery of digital goods and services" as a key pressure area that must be addressed by the BEPS project, later reflected in action item 1. *See* OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING, *supra* note 10, at 47.

> services. Such work will require a thorough analysis of the various business models in this sector.[41]

Indeed, BEPS is first and foremost about globalization and MNEs. As a business model, MNEs can only be justified by significant intangible content,[42] which is naturally augmented by the ascent of the digital economy and its contribution to globalization. Therefore, it is natural for the BEPS project to focus on the advantages that the digital economy provides to MNEs. However, not just a macro view justifies focus on the digital economy and transactions in intangibles; such a focus is also dictated by the immediate triggering of the public interest in BEPS and the tax planning schemes of the largest MNEs—such as Apple, Microsoft, and Google—all of which have business models heavily relying on intangibles.[43]

The challenge of this "new economy" is not new, of course. The OECD—together with essentially all countries—struggled with it in the near past. The OECD was rather successful in reaching some sort of a consensus on the most critical issues—mainly those concerning PEs—at a time when most countries had remained helpless and unable to act unilaterally.[44] Nonetheless, such success provided only a Band-Aid for a more serious hurt. BEPS has proven that the most critical conclusion of the OECD at that time cannot be sustained in the long run:

> As regards the various alternatives for fundamental changes … the TAG concluded that it would not be appropriate to embark on such changes at this time. Indeed, at this stage, e-commerce and other business models resulting from new communication technologies would not, by themselves, justify a dramatic departure from the current rules. Contrary to early predictions, there does not seem to be actual evidence that the communications efficiencies of the internet have caused any significant decrease to the tax revenues of capital importing countries.[45]

The BEPS project acknowledged that even if the above was correct in 1999, it isn't so at the present. It is easy to see how the fundamental

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41. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 1, at 14.

42. RICHARD E. CAVES, MULTINATIONAL ENTERPRISE AND ECONOMIC ANALYSIS 162–88 (2d ed. 1996) (explaining the advantage of MNEs as hierarchies under the transaction cost model vis-a-vis contractors on the market).

43. *See, e.g.*, *supra* notes 2–3.

44. Primarily with the adoption of the new, specific commentary on Article 5.

45. OECD, TAXING BUSINESS PROFITS, *supra* note 39, ¶ 350, at 72.

principles of BEPS come into play in the context of this action item. First, the third principle is stated clearly here—continuing to tweak the old rules is not acceptable; the new economy requires new, innovative solutions. The action item also explicitly mentions the second principle of BEPS—the need for a holistic approach, including an interesting mention of the desirability of coordinating income and consumption taxation. Finally, the first principle of BEPS becomes obviously relevant when the technical challenges presented by the digital economy are analyzed. It is apparent that in this context unilateral action did not work in the past and cannot work in the present, necessitating a more serious attempt at international cooperation.

What then are these technical challenges? The 1990s work focused on permanent establishment ("PE") issues—primarily on the question of whether a PE can be triggered without people on the ground—and the scope is now significantly expanded by the BEPS project. Action item one begins its description of issues with the same PE issue, yet it uses a more general language of "nexus" and taxable presence, not limiting itself to the PE questions of past. Further, it mentions the difficulty of attributing profits to potentially taxable presence of the digital kind. This language may imply that the OECD wishes to reform and regulate the entire taxing regime applicable to cross-border digital business income. This wish is consistent with a will for a more comprehensive reform. However, the action item specifically mentions attribution of profits related to the controversial marketing intangibles, which is a rather marginal issue promoted by the United States with little enthusiasm among other countries and the OECD.[46] Next, the action item mentions the important interaction and similar problems faced by non-income taxes. Finally, the action item specifically mentions the inherent difficulty of classifying and sourcing income from intangibles and—indirectly—also the difficulty of valuing various intangibles.

The articulation and order of issues are puzzling. It looks like an almost accidental mix of general issues—mostly important but inconsistently organized—as if it were just a few examples thrown in about the challenges presented by the digital economy. Yet, a second glance reveals that this is a list of issues that the OECD has already been working on, and for these issues it can present some results. Necessarily, the list includes articulation of specific doctrinal spheres rather than a discussion of conceptual issues. This is disconcerting. It clearly demonstrates that the OECD is treading in the familiar territories of traditional and limited doctrinal analysis. Such an analysis is unlikely to be holistic or open to innovation, and it is definitely unlikely to lead to a change in paradigm.

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46. The Glaxo dispute is a good example for the potential conflicts over marketing intangibles. *See, e.g.*, Audrey Nutt, *Glaxo, U.S. Settle Transfer Pricing Dispute*, 43 TAX NOTES INT'L 956 (Sept. 18, 2006).

This concern is exacerbated by the choice of the OECD—explained perhaps by the tight time frame—to aspire only to a report about the challenges presented by the digital economy rather than request analysis and solutions.[47] Further, the report is requested from a special task force created from government officials by the OECD, yet not within the OECD where true action is expected.[48]

The issues that the BEPS project must address include, first, a clear acknowledgement that intangibles and e-commerce are different and therefore require fitting treatment rather than application of old doctrine by analogy. This means, for example, that physical presence simply cannot be the only trigger of tax jurisdiction—as it is essentially now. This is the principle that needs to be reduced to operating rules. A traditional approach would be to adjust the PE rules to this principle. This may be possible, but would require a much more sophisticated approach to the PE rules. The problem is that there is significant resistance to a fundamental revision of the PE rules. The United States is leading this opposition to progress[49]—perhaps believing that it would primarily affect United States MNEs—yet ignoring the fact that it is the conduct of these MNEs that triggered BEPS in the first place. In fact, the United States opposes the inclusion of action item one in the BEPS project, which signals that it opposes the project's developing into a major overhaul of the international tax regime. The United States perhaps wishes to view action item one as a device for countering the most egregious abusive behavior,[50] very much in line of traditional OECD action and in stark

47. See the explanation of OECD official Mr. Raffaele Russo, OECD, *BEPS Action Plan*, *supra* note 9.

48. *Id.*

49. *See, e.g.*, Lee A. Sheppard, *The Digital Economy and Permanent Establishment*, 70 TAX NOTES INT'L 297 (April 22, 2013) [hereinafter Sheppard, *The Digital Economy*]; Lee A. Sheppard & Jaime Arora, *ABA Meeting: Multinationals Must Accept BEPS Project, U.S. Official Says*, 70 TAX NOTES INT'L 727 (May 20, 2013) [hereinafter Sheppard & Arora, *ABA Meeting*] (quoting Robert Stack, the United States Treasury deputy assistant secretary (international tax affairs), stating, *inter alia*: "Digital income is not something that needs to be separately broken out.").

50. *See, e.g.*, Sheppard & Arora, *ABA Meeting*, *supra* note 49; Kristen Parillo, *Days of Double Non-Taxation Are Over, U.S. Treasury official Says*, 139 TAX NOTES 1217 (June 10, 2013) (quoting, again, Mr. Stack, the United States Treasury deputy assistant secretary (international tax affairs), stating: "[F]rom the U.S. standpoint, the BEPS project is about addressing the stripping of income from higher-tax jurisdictions into low- or no-tax jurisdictions. That's a really important point because it's not a project that is about a fundamental reexamination of residence and source country taxation. . . . That debate can happen at another place and another time.").

contrast to the fundamental principles of the BEPS project as exposed by this Article.

This Article suggests that another approach—more transparent and more consistent with the three principles of BEPS—would be to seek a formulary taxing scheme for "digital" business income.[51] This would require collaboration among jurisdictions so that they can agree on the parameters included in such formulary taxation; yet, as already explained, developing mechanisms for such collaboration is the primary task of the BEPS project and the necessary consequence of its key insight about the inevitability of cooperation. This type of solution also would be consistent with the third principle of BEPS because it requires innovation—formulary taxation—that has been rejected by the OECD to date.

A second fundamental issue that this action item must address relates to the valuation of intangibles—the acknowledged difficulty of which is the source of many of the relevant issues. The action item does not mention it because it has been relegated to the transfer-pricing portion of the action plan.[52] Unexplored is the unique power of network effects on intangibles and their interconnected value that is often difficult to bifurcate and separate into defined, separate items—as required by the current tax rules. Again, a more sophisticated approach is required here, perhaps in deviation from the orthodoxy and beyond the language of the action item. A related fundamental issue of the source of digital income is simply ignored. It should, of course, come up in the task force's work, but it demonstrates the insufficiency of the language of this action item. Another example is the mention of marketing intangibles that are controversial but do not represent a key element in BEPS. In the context of source there are some fundamental issues that must be addressed, although their comprehensive analysis is beyond the scope of this Article. First is the issue of services. This has been a major bone of controversy between developing countries and the OECD, and has led to extensive work within the OECD and even the U.N.[53] Much of the digital economy involves services and income that is defined—controversially at times—as income from services. An exposition of the digital economy cannot be complete without a serious treatment of this issue. A second issue—distinct, yet similar in principle—is the treatment of

51. For an example of a proposal to adopt formulary taxation of business profits more generally, see, for example, Reuven S. Avi-Yonah & Kimberly Clausing, *Reforming Corporate Taxation in the Global Economy: A Proposal to Adopt Formulary Apportionment*, *in* PATH TO PROSPERITY: HAMILTON PROJECT IDEAS ON INCOME SECURITY, EDUCATION AND TAXES 319–44 (Furman & Bordorff eds., 2008).

52. And therefore the Article discusses its details below as well.

53. See the U.N. dedicated website, http://www.un.org/esa/ffd/tax/documents/bgrd_model_tts.htm (last visited Mar. 29, 2014).

information, or data, which has grown to be a major factor in the creation of value by the digital economy. A recent report by French officials raised much controversy, concluding that such data provided by consumers requires shift of significant taxing rights to such consumers' residence countries—which are normally viewed as source countries by the traditional analysis.[54]

The test for the OECD would be to tackle these conceptual challenges that are truly presented by the digital economy, avoiding the ubiquitous resort to the "difficult cases are difficult" rhetoric. Similarly, it should ignore the notation in the action plan that "a different distribution of taxing rights which may lead to low taxation is not per se an indicator of defects in the existing system."[55] This statement may be interpreted as a mild statement to relieve concern among MNEs about the OECD targeting their tax planning "rights." But in the context of BEPS, one should be concerned that a fundamental point would be overlooked—that despite the difficulty of determining where value is created, it is not difficult to understand where it is not created. Value is not created where significant R&D does not take place; it is not created where flesh and blood are not present to take all the important decisions about the exploitation of the intangibles, regardless of the distinction between strategic and day-to-day decisions; and it is not created where it is not significantly exploited for the betterment of a large number of human beings. This means that value cannot be determined to be significantly created in places where tax rates are uniquely low.

In conclusion, action item one raises some concern about the potential consistency of the relevant project's action with the fundamental principles of BEPS, yet many of the issues that may and should be immediately addressed are included in action items of the second group, discussed below—including primarily PE issues, hybrid mismatch arrangements, and transfer pricing. One hopes that the task force charged with this non-action item will indeed deal with the conceptual issues presented above consistently with the fundamental principles of BEPS as explained by this Part.

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54. Nicolas Colin, *Corporate Tax 2.0: Why France and the World Need a New Tax System for the Digital Age*, FORBES (Jan. 28, 2013), http://www.forbes.com/sites/singularity/2013/01/28/corporate-tax-2-0-why-france-and-the-world-need-a-new-tax-system-for-the-digital-age/ (review of the report by one of its coauthors); *see also* Sheppard, *The Digital Economy*, *supra* note 49.

55. OECD, *BEPS Action Plan*, *supra* note 9, at 10.

2. *Action Item 5 ("Counter Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance")*

Similar to action item one, this is a general, overarching item; its somewhat vague language necessarily covers issues that are specifically included in other action items. Yet there is history here and—not unlike a few other BEPS project items—it is a history of failure. This action item should therefore be read in context—narrower than what its language implies—as an attempt to resuscitate the OECD's harmful tax competition campaign.[56]

As such, this action item is about tax havens, non-haven offshore regimes, and similar rent-seeking and other beggar-thy-neighbor regimes in traditionally high-tax jurisdictions. These regimes are the rougher tools of the trade of players involved in current tax competition. In the harmful tax competition campaign, the OECD has used a carrot-and-stick approach, based on its traditional competition-based paradigm, to convince all of the above regimes to adopt some transparency measures—mainly in the form of enhanced information exchange. The idea was that transparency is the cure-all, most appropriate mechanism to smooth the rough edges—consequently perfecting international tax competition. Again, the competition paradigm continuously failed. Regardless, change of paradigm to enhanced coordination was not considered.

The BEPS project should change this process because its fundamental insight is exactly about the need to rethink the role and intensity of competition in the international tax regime. However, such rethinking cannot be found in the language of this action item. Disappointingly, it calls for a "revamp" of current efforts, albeit with renewed spirit.

> Revamp 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. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the

56. The OECD has even discontinued the maintenance of its relevant website. *See also, e.g.*, Mindy Herzfeld, *News Analysis: Political Reality Catches Up With BEPS*, 73 TAX NOTES INT'L 387 (Feb. 3, 2014) (reviewing the past Harmful Tax Competition campaign and concluding that the current initiative is also likely to fail). For a more optimistic view of the campaign, yet one that includes a fair, and not so favorable, evaluation of it, see Avi-Yonah, *Harmful Tax Competition Report*, *supra* note 30.

> existing framework and consider revisions or additions to the existing framework.[57]

Realistically, it is probably essential to have a universal norm about what is and is not acceptable in terms of preferential regimes. Acquiring information about the regimes and their scope is important, of course, and indeed action items 11 and 12 complement this item by calling for collection of information on tax planning. This action item, however, should be more important for the mission of the BEPS project because it deals with the structure of the regime that permits taxpayers to engage in BEPS-type planning. Yet it is not so much the knowledge about preferential tax regimes that is concerning because our globalizing world realistically permits little space for that; it is about the use of these regimes by taxpayers that concerns tax authorities. It is necessary to secure the availability of such information, yet it is not sufficient for two related reasons. First, so long as tax competition dominates the international tax regime, the flow of information can be improved, but never perfected because there is simply too much to lose—or gain—from minor to major noncooperation. As has been proven to date, defection is the rational course of action. Collective action led by the most powerful countries could change this outcome, and indeed, this had been understood and implemented with the constitution of the "Global Forum" that shows promise in this context.[58] The BEPS project should complement this progress and overcome the second difficulty that prevented success from the harmful tax competition campaign by a setting of standards. Tax experts often favor smell tests for identification of too aggressive planning schemes, yet that is not enough when the stakes are too high as they are in this context. This is consistent with the first principle of BEPS—that unilateral action can never overcome the BEPS challenge. Absent a universal standard, countries are likely to either undershoot or overshoot when setting their anti-abuse standards; their differing interests will continue to interpret into a variety of standards, keeping the door open to BEPS planning.

The action plan does show some promise in this context. First, it adds a vague yet meaningful reference to reliance on "substance"—as opposed to only transparency—in the combat of harmful tax competition.[59] Then, it establishes what looks like a principle—a link between legitimate

57. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 5, at 18.

58. See the website of the Global Forum on Transparency and Exchange of Information for Tax Purposes for its myriad actions and progress made: http://www.oecd.org/tax/transparency/ (last visited Mar. 29, 2014).

59. *See* OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, at 17.

tax planning and value creation.[60] Although simple, many of the obviously illegitimate preferential regimes should be caught in this principle if the principle is clearly articulated. The action plan's commitment to a holistic approach inherently calls for principle driven outcomes; this could be a meaningful first step, although one should note that there is unfortunately no sign that the BEPS project is heading in this direction.

A second positive sign within this admittedly disappointing action item is the direct reference to the need to be inclusive and engage non-OECD members in the process. Despite this reference, the language of this action item hints that the OECD still views itself primarily as the rich countries' club, which raises a question about its charge with the BEPS project. It is unclear whether the OECD is a faithful agent of the G20, a partner of the G20, or perhaps, completely independent of the G20 although engaged in a discourse with it. This is important for the legitimacy of the BEPS project. Recreating the "us" and "them" in this context is awkward and contrary to the fundamental insight of BEPS about collaboration and the futility of unilateralism. The key "them" countries—such as the BRICS—are G20 leaders, while many OECD members are not. Therefore, conflict may not even be desirable for many OECD members—not to speak of the OECD as a separate political institution. This is perhaps merely an unfortunate piece of drafting, yet attention must be paid to it in order to eliminate the threat of illegitimacy.

Finally, the most obvious outcome, or deliverable expected from this action item should be the naming of at least the most obviously objectionable regimes associated with BEPS.[61] Unfortunately, the action plan refrains from specifying any regimes, although a lot of talk has pointed to some of them—most notably to the so-called patent box regimes. It is generally thought that these regimes will be specifically covered by the deliverables related to this action item;[62] not doing so would clearly harm the legitimacy of the project.

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60. *See, e.g.*, *id.* at 18.

61. For a similar point and critique of this action item, see Joachim Englisch & Anzhela Yevgenyeva, *The "Upgraded" Strategy Against Harmful Tax Practices Under the BEPS Action Plan*, 5 BRIT. TAX REV. 620 (2013).

62. Nonetheless, there is expected to be severe political opposition to such mentioning. The U.K.—following several European countries—has only recently adopted a patent box regime, although with a somewhat mild effect due to which it is expected to clear current standards. *See, e.g.*, Jeffrey Owens, *How the BEPS Project Should Tackle Harmful Tax Competition*, INT'L TAX REV. PREMIUM (Nov. 5, 2013), http://www.internationaltaxreview.com/Article/3275221/How-the-BEPS-project-should-tackle-harmful-tax-competition.html (the former person-in-charge of tax matters at the OECD commenting on action item 5, advocating standard setting similar to that supported by this Article, calling for an evaluation of patent box regimes in light of these standards, yet assessing that the U.K. regime would clear such an examination). *But see* David D. Stewart, *BEPS Seen as Area of Both*

In conclusion, there is much uncertainty about the outcome of this action item. Its direct tie to past failure of the OECD further reduces the promise it may present. Yet this is an important pillar in the path to international tax reform. Successful treading on such a path would require consistency with the fundamental principles of BEPS. First, substantive, principled standard setting should be an important part of the outcome—beyond enhanced transparency. A clear statement of the necessary tie between value creation and tax jurisdiction would be a desirable first step. Second, it must include a specification of what is and is not acceptable—beyond merely declaring a standard—and it is probably impractical to avoid reference to political hot potatoes such as IP "boxes." Finally, this should be achieved collaboratively in an inclusive manner, ensuring effectiveness and winning the most legitimacy possible.

B. The Specific Challenges

In the eye of the BEPS storm there are several specific measures that are candidates for meaningful reform. These reforms may be the only practical important outcome of BEPS, especially if the true uphill battle towards an improved international tax regime based on cooperation and coordination of tax policies is not quickly won.

1. Action Item 2 ("Neutralise the Effects of Hybrid Mismatch Arrangements")

The most direct embodiment of BEPS planning—perhaps beyond its transfer pricing elements—is the set of situations described in this action item. The outcome and the problematic aspects of this type of tax planning directly correspond to the key insight of BEPS: different countries independently employ different—apparently incompatible, yet independently logical—tax rules to similar circumstances, and consequently open the door to arbitrage. Such arbitrage is widely considered abusive. From a technical perspective, such arbitrage leads to what is widely called now "double non-taxation," that is, taxation of circumstances or transactions at a level that is lower than they would have faced in a purely domestic setting. Double non-

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Consensus and Conflict, 140 TAX NOTES 1387 (Sept. 23, 2013) [hereinafter Stewart, *BEPS Seen as Area of Both Consensus and Conflict*] (quoting Robert Stack, the United States Treasury deputy assistant secretary (international tax affairs), questioning the United Kingdom's commitment to the initiative to combat profit shifting and base erosion in light of its own patent box regime). Switzerland also has voiced its intention to strongly protect its own patent box regime. *See, e.g.*, Robert Danon, Ed., *Proceedings of the Swiss "Rethinking Corporate Tax Policy"* conference at the University of Lausanne (Dec. 9-10, 2013) (forthcoming 2014).

taxation is a violation of "the single tax principle"—one of the fundamental principles of the international tax regime.[63] The first principle of BEPS effectively enforces the single tax principle, requiring collaboration to close the gaps between the rules that permit BEPS, in light of the understanding that unilateral action—even when it is independently rational—simply cannot do that. The action item responds to the challenge with a call to:

> Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include:
>
> (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly;
>
> (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor;
>
> (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules);
>
> (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and

63. Double non-taxation is the mirror image of double taxation, or over-taxation, of cross-border transactions that had long been acknowledged undesirable as an obstacle to cross-border trade and investment. This goes back to post-WWI and the League of Nations' work on tax treaties. *See, e.g.*, Sunita Jogarajan, *Stamp, Seligman and the Drafting of the 1923 Experts' Report on Double Taxation*, 5 WORLD TAX J. 368 (2013) (exposing the history of the League of Nations tax treaty work and the centrality of double taxation to this work); A. J. van den Tempel, RELIEF FROM DOUBLE TAXATION (IBFD, 1967) (extending the analysis to the takeover of the tax treaty project by the OECD from the League of Nations). The main milestone in the launch of double non-taxation as a corollary to double taxation is probably its choice as a main issue in the 2004 IFA congress in Vienna. *See* IFA, CAHIERS DE DROIT FISCAL INT'L, Vol. 89a (2004). For a review of the evolution of the single tax principle, see Reuven S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy* (Univ. of Mich. Pub. Law, Research Paper No. 318, 2014), http://ssrn.com/abstract=2226309. The original exposition of the single tax principle as a fundamental pillar of the international tax regime was in Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507 (1997).

> (v) where necessary, guidance on co-ordination or tie-breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping.[64]

Like most of the action plan, the struggle with hybrids is not new to the OECD. In fact, just recently the OECD concluded work on the very same problem, resulting in a 2012 report.[65] The OECD generally points to this report as a solution associated with action item two, although it has not clearly clarified if more is to come on this.[66] The problem with this approach is that the 2012 report was prepared and published prior to the BEPS initiative. It was prepared under the former OECD approach and was not based on the BEPS insight about the necessity of coordination to resolve the collective action problem. Finally, the 2012 report was an OECD report and did not give voice to the BEPS group of countries, however defined.

This is a conceptual conflict, not just a technical one. This is easy to notice when reading the conclusions of the 2012 report. These conclusions advocate domestic-law-based solutions, mainly anti-abuse rules to negate some of the practices identified as abusive.[67] The 2012 report reviewed a variety of domestic anti-abuse norms that responded to various abusive hybridization practices and concluded that they were successful in combating such practices.[68] Consequently, the report recommended the use of domestic anti-abuse rules as a solution to the problem of hybrid mismatch arrangements.[69] Regardless of assessment of the quality of this conclusion for OECD countries,[70] it is apparent that it contradicts the first principle of

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64. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 2, at 15.

65. OECD, HYBRID MISMATCH ARRANGEMENTS: TAX POLICY AND COMPLIANCE ISSUES (2012), http://www.oecd.org/ctp/aggressive/HYBRIDS_ENG_Final_October2012.pdf [hereinafter OECD, HYBRID MISMATCH ARRANGEMENTS].

66. *See, e.g.*, OECD, *BEPS Action Plan*, *supra* note 9.

67. OECD, HYBRID MISMATCH ARRANGEMENTS, *supra* note 65, at 25.

68. *Id.* at 23–24.

69. *Id.* at 25.

70. And these conclusions should be doubted. Contrary to the OECD's 2012 report position, current treaty practice teaches us that domestic solutions are at best partial and remedial, and at worst, they may further complicate the picture and enhance the mismatches that generated the problem in the first place. Further, it teaches us that remedial or small-scale treaty norms—such as beneficial ownership

BEPS, based on the insight that unilateral action can never succeed in curbing BEPS. It is not surprising that this conclusion is consistent with the traditional OECD competition-promoting approach because the report was prepared pursuant to that approach and at a time when such an approach dominated OECD practice.

Now, hybrid mismatch arrangements include various challenges in practice. One group of challenges concerns entity classification issues, including well-known issues regarding the treatment of partnerships under tax treaties,[71] the classification and tax treatment of other transparent and hybrid entities, and the classification of nontraditional relevant norms, such as the United States' check-the-box regime ("CTB") that permits essentially at-will elective changes of entity classification.[72]

A second group of challenges concerns hybrid instruments, such as derivative financial instruments. The challenge is to reconcile the classification of such instruments among the competing or relevant tax jurisdictions. The primary choice here is between debt and equity classifications that have been done using a binary, all-or-nothing decision rule essentially in all jurisdictions.

Finally, a third group of challenges concerns classification of potential hybrid transactions. These may be financial transactions—principally similar to the derivative instruments already described—or transactions involving intangibles—such as software—where the different countries involved classify them differently, leading to situations where certain benefits could be claimed twice. For example, if two countries view different taxpayers as "owners" of a certain property, they could both claim depreciation or amortization deductions at the same time for that property.[73]

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and the conflict of qualification commentaries—are insufficient. *See, e.g.*, Michael Lang, Pasquale Pistone, Josef Schuch, Claus Staringer & Alfred Storck, BENEFICIAL OWNERSHIP: RECENT TRENDS (IBFD, 2013).

71. *See* OECD, THE APPLICATION OF THE OECD MODEL TAX CONVENTION TO PARTNERSHIPS (OECD, Issues in International Taxation, No. 6, 1999) [hereinafter OECD, THE APPLICATION OF THE OECD MODEL TAX CONVENTION TO PARTNERSHIPS]; MICHAEL LANG, THE APPLICATION OF THE OECD MODEL TAX CONVENTION TO PARTNERSHIPS: A CRITICAL ANALYSIS OF THE REPORT PREPARED BY THE OECD COMMITTEE ON FISCAL AFFAIRS (Linde Verlag Wien, 2000) [hereinafter LANG, A CRITICAL ANALYSIS OF THE REPORT PREPARED BY THE OECD].

72. Reg. § 301.7701-3. CTB apparently came under significant scrutiny in the BEPS context, yet the United States appears adamant on keeping it. *See, e.g.*, Stewart, *BEPS Seen as Area of Both Consensus and Conflict*, *supra* note 62.

73. *See, e.g.*, an example of this in an aircraft-leasing context, T.A.M. 1997-48-005 *(August 19, 1997).*

As is well known from practice experience[74]—and more recently from studies performed by several countries, with more countries joining the process—there is a wide variety of opportunities to abuse such mismatches, leading to the conclusion that only coordination may prevent it.[75] Whatever solution is adopted, not all countries are expected to end up winners in revenue and short-term welfare terms. Therefore, spontaneous coordination is unlikely to occur. Nonetheless, neither the 2012 report nor the BEPS project reports have addressed the challenge of coordination.

Rather, the reports focus solely on the technical details and the most obvious issues attracting public attention: transactions that twice took advantage of a deduction for a single expense, transactions where an expense was deducted yet the income generated by it was not included in income, and transactions that generate the benefit of foreign tax credits beyond the taxation of the underlying income—known as foreign tax generators. These transactions are considered undesirable because of the revenue lost and the unintended competitive advantage they provide to MNEs—manifested in inefficiency and unfairness. Note that it is not obvious that incentivizing MNEs is per se desirable, and this may very well be a major motivation behind the norm of the current international tax regime. Essentially all countries incentivize R&D and transfers of intangibles, which are the very reason for the existence of MNEs. Essentially all countries use the arm's length principle and typically the concept of arm's length range—again to

74. The many examples include the so-called DCL cases, where United States and United Kingdom domestic actions failed to remedy a double deduction of losses situation—the very same issue raised by the 2012 report—eventually resorting to coordination via a competent authorities agreement. *See, e.g.*, Lewis J. Greenwald & Jeffrey L. Rubinger, *The New U.K.-U.S. Agreement on Dual Consolidated Losses*, 113 TAX NOTES 841 (Nov. 27, 2006). Other well-known conflicts include the differences in corporate residence rules that are not currently resolved. It is generally understood that a simple tiebreaker cannot be designed in such situation where the conflict is substantive. *See, e.g.*, Robert Couzin, CORPORATE RESIDENCE AND INTERNATIONAL TAXATION (IBFD, 2002). A similar problem exists with respect to partnerships and hybrid and other transparent entities. *See, e.g.*, OECD, THE APPLICATION OF THE OECD MODEL TAX CONVENTION TO PARTNERSHIPS, *supra* note 71; LANG, A CRITICAL ANALYSIS OF THE REPORT PREPARED BY THE OECD, *supra* note 71; Martin H. Seevers, *Taxation of Partnerships and Partners Engaged in International Transactions: Issues in Cross Border Transactions in Germany and the U.S.*, 2 HOUS. BUS. & TAX L.J. 143 (2001).

75. *See, e.g.*, AUSTL. TREASURY DEP'T, SCOPING PAPER ON RISKS TO THE SUSTAINABILITY OF AUSTRALIA'S CORPORATE TAX BASE (2013), http://www.treasury.gov.au/PublicationsAndMedia/Publications/2013/Aus-Corporate-Tax-Base-Sustainability/HTML; Svethan-Eric Bärsch & Christoph Spengel, *Hybrid Mismatch Arrangements: OECD Recommendations and German Practice*, 67 BULL. INT'L TAX. 520 (2013); Omar Zúñiga, *The New Mexican BEPS Legislation*, 73 TAX NOTES INT'L 77 (Jan. 7, 2014).

the sole benefit of MNEs.[76] So, not only is a normative analysis missing in the action plan, but also a serious evaluation of the principles of the current system.

This difficulty is exacerbated when the solutions proposed are domestic and are specific anti-abuse rules ("SAARs"), not general anti-abuse rules ("GAARs"). GAARs are rejected because they primarily target artificial arrangements when the target of the hybrids challenge is non-artificial arrangements. Finally, the 2012 report advocates more exchange of information. This approach is not consistent with the principles of BEPS. It is diametrically opposite to the first principle as already explained; it advocates ad hoc solutions to the most visible symptoms rather than a holistic solution, as is required by the second principle of BEPS, and it completely lacks innovation or even a consideration of a new approach to the issue.

Neither the 2012 report nor the action plan mention the difficulty of dealing with mismatches not only of rules but also of their implementation. It is likely that the single largest contributor to the issues that triggered the attention to BEPS is the distortion created by the implementation of transfer pricing valuation techniques by United States MNEs,[77] supported by the courts' endorsement of the literal arm's length principle.[78] Coordinating implementation is indeed a difficult task, yet the action item comes very short of trying to deal with the problem. It states that only "where necessary, guidance on co-ordination or tie-breaker rules" will be considered.[79] Again, this shortcut approach is apparently inconsistent with the BEPS principles.[80] Specifically, the intangibles valuation issue may fare better under action item eight, discussed below, yet it should be mentioned here that that would require accepting innovation, consistent with the third principle of BEPS.

In conclusion, at this time, action item two does not provide hope for progress, despite its centrality to the BEPS project. As explained, only adherence to the principles of BEPS—particularly an implementation of a collaborative process—would give it a chance of success.

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76. *See, e.g.*, Brauner, *Value*, *supra* note 5.

77. *See, e.g.*, *id.*; Yariv Brauner, *Cost Sharing and the Acrobatics of Arm's Length Taxation*, 38 INTERTAX 554 (2010) [hereinafter Brauner, *Cost Sharing*].

78. Brauner, *Cost Sharing*, *supra* note 77.

79. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 2, at 15.

80. Note, however, that considering an enhanced use of the tie-breaking rule is positive because it provides a decision rule that must be agreed upon collectively and has proven useful in other contexts.

2. Action Item 3 ("Strengthen CFC Rules")

At face value, this is indeed an important component of an anti-BEPS initiative. Deferral is an important feature of tax planning in the United States, as well as most other productive countries. Therefore reform of anti-deferral regimes—such as CFC rules—supposedly makes sense within the project. It is not only important but also relevant because the schemes that brought BEPS to the top of the agenda exposed some of the most conspicuous failures of the United States' subpart F regime[81]—including the inability to capture royalty income from foreign exploitation of intangibles of United States MNEs and the use of the so-called same country exception in the "Dutch Sandwich" scheme.[82]

Nonetheless, the action item and its preamble lack much content. The action item calls for "[d]evelop[ing] recommendations regarding the design of controlled foreign company rules. This work will be co-ordinated with other work as necessary."[83] This presumably means that the OECD views the CFC rules as domestic regimes that—perhaps due to domestic political pressures or even incompetence—do not follow best practices. In response, the OECD presumably expects to specify such best practices to assist countries in implementing these necessary domestic norms. The action item does not even strongly commit to specific coordination of the work on action item three with other action items, using the vague statement "as necessary."[84] Resorting to best practices guidance may be practical and necessary, or even the sole realistic progress available for the OECD; yet the OECD should be aware of the fact that this guidance is inconsistent with the first principle of BEPS and that therefore it is likely to eventually fail.

To understand the difficulty of reforming CFC regimes, one must recall that the OECD views such regimes as purely domestic anti-abuse rules.[85] Pursuant to these regimes, the country of residence of a parent corporation ("P"), for example, is permitted to currently tax income generated by a foreign subsidiary of such parent corporation ("ForSub").

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81. This is Subpart F of the Code, §§ 951–960, which includes the United States' CFC rules.

82. These schemes were widely exposed elsewhere. *See, e.g.*, *supra* notes 2–3.

83. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 3, at 16.

84. *Id.*

85. See OECD, Commentary, *supra* note 20, at art. 1, ¶ 23; art. 7, ¶ 14; and art. 10, ¶ 37, all added in 1992 (and later modified, yet not substantively). *See also* OECD, CONTROLLED FOREIGN COMPANY LEGISLATION (1996) [hereinafter OECD, CONTROLLED FOREIGN COMPANY LEGISLATION] (including the original comparative study of CFC regimes by the OECD).

Normally, countries refrain from taxing "foreign source" income[86] of nonresidents—such as ForSub—even when such nonresidents are strongly related or even wholly owned by residents, thus permitting deferral of domestic taxation of such income as a general rule. Tax treaties, if applicable, explicitly forbid such taxation.[87] Yet many countries were concerned that deferral might be abused in some cases by taxpayers diverting income to corporations with residence in low-tax jurisdictions solely to minimize taxation. One solution for this concern has been to enact CFC legislation that specified such potentially abusive circumstances and typically provided that when appropriate they would view the income earned by the foreign corporation (ForSub in our example) as if it were earned directly by the resident (P in our example), leading to current taxation and eliminating the benefits of deferral. Different countries use different technical mechanisms to achieve the same ends, yet they all refrain from directly limiting the tax jurisdiction of the source country (ForSub's country of residence), and therefore they view their CFC regimes as entirely "domestic," taxing residents (such as P) on "their" income—even though the income became "their" income as a consequence of the atypical attribution rule embedded in the CFC regimes themselves. The OECD accepted the position that such regimes are indeed purely domestic, primarily because they do not directly restrict the tax jurisdictions exclusively assigned by tax treaties to source jurisdictions (such as ForSub's country of residence).[88]

This is another prime example for this Article's claim that the international tax regime is based on competition rather than coordination. Realistically, these circumstances involve a source country that taxes certain income too lightly in the view of a residence country. It does so with the aim to attract investment or rents. The residence country also "competes" on the world market by adhering to deferral as a general rule. This is typically explained as helpful for domestic MNEs competing for foreign investment (such as investment in ForSub's country of residence).[89] Yet the residence country needs to balance the support of its MNEs with concerns about the abuse opportunity that deferral provides. CFC regimes are attempts to set this balance unilaterally without correspondence with the source jurisdiction

86. That is, income with no acceptable links to the jurisdiction of P's country of residence.

87. Typically in art. 7, ¶ 1, such as that of the 2010 OECD Model Tax Convention.

88. *Id.*

89. *See, e.g.*, the debate over the legislation of the United States' Subpart F regime that reflected a compromise between the desire of the Kennedy administration to eliminate deferral and the competitiveness concerns of other political figures. *See* Revenue Act of 1962, Pub. L. No. 87-834, 76 Stat. 960; H.R. REP. NO. 1447, 87th Cong., 2d Sess. (1962); S. REP. NO. 1881, 87th Cong., 2d Sess. (1962); H.R. CONF. REP. NO. 2508, 87th Cong., 2d Sess. (1962).

involved. The more straightforward solution of coordination of tax policies among the residence and source countries never comes into consideration because the countries are first and foremost in competition with each other and with all other countries. Consequently, the policies of the source and residence countries are not reconciled; they either overlap, resulting in potential double taxation, or create gaps of coverage resulting in double non-taxation to the advantage of MNEs. The latter is the more likely consequence due to the resolve and power of MNEs.[90] Therefore, there should be no reason to believe that continuing down this path—contrary to the most fundamental insight of BEPS—would lead to better results.

In addition, one may question the wisdom of the choice to focus on CFC regimes here despite the intuition implied above that they belong. As mentioned in the preamble to the action item, the OECD has not done much work in this area beyond legitimizing CFC legislation as not contradictory to tax treaty obligations. CFC regimes are a common title for a variety of legal constructs that tax income from foreign investment of resident taxpayers.[91] Nonetheless, the value of deferral is not merely the time value of money supposedly gained, but is in ancillary rules and potential rate changes that make deferral attractive for tax planning.[92] These different methods have slightly different goals and effects and so it may prove tricky to develop "best practices" here.

Moreover, an analysis of the most notorious BEPS schemes demonstrates that the primary damage to the home or residence countries in such transactions—typically the United States—had nothing to do with their indeed weak CFC rules, but rather with their transfer pricing rules. One may argue that it would not matter if such countries repealed deferral,[93] yet this is

90. In the United States this is clearly the case, as economists have extensively discovered with access to actual tax return data in recent years. *See, e.g.*, Harry Grubert & Rosanne Altshuler, *Fixing the System: An Analysis of Alternative Proposals for the Reform of International Tax*, 66 NAT'L TAX J. 671 (2013); Harry Grubert, *Foreign Taxes and the Growing Share of U.S. Multinational Company Income Abroad: Profits, Not Sales, Are Being Globalized*, 65 NAT'L TAX J. 247 (2012). Also, notably, law Professor Edward D. Kleinbard explored this phenomenon in a wider scope than CFC regimes. Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699 (2011) [hereinafter Kleinbard, *Stateless Income*].

91. See, for example, the OECD's own comparative study in OECD, CONTROLLED FOREIGN COMPANY LEGISLATION, *supra* note 85. See also a recent study of these regimes in Peter Schmidt, *The Taxation of Foreign Passive Income for Groups and Companies*, 98a CAHIERS DE DROIT FISCAL INT'L 259 (2013).

92. As explained in DANIEL N. SHAVIRO, FIXING U.S. INTERNATIONAL TAXATION (2014).

93. This is a viable option, often advocated for a variety of reasons unrelated to BEPS. *See, e.g.*, Robert J. Peroni, J. Clifton Fleming, Jr. & Stephen E. Shay, *Getting Serious About Curtailing Deferral of U.S. Tax on Foreign Source Income*, 52 SMU L. REV. 455 (1999).

beside the point because fixing CFC rules is not about the repeal of deferral; on the contrary, the rules define the boundaries of permitted deferral. As mentioned by the OECD in the preamble to the action item, it is not only the residence country that benefits from effective CFC rules. Indeed, the Google case demonstrates this point because its "Double-Dutch" scheme effectively reduced the Irish rather than the United States' taxation of Google. Yet Ireland in that scheme is not exactly the source jurisdiction, which reduces the justification of focusing on CFC regimes within the BEPS project.

This does not mean that tightening the CFC rules may not help in curbing some BEPS through increased costs for tax planning or the reveal of some information, yet it should be noted that it is no cure-all and acknowledged that its potential is limited in this context.[94]

3. Action Item 4 ("Limit Base Erosion via Interest Deductions and Other Financial Payments")

This is perhaps the most actively promising action item according to common speculation among the international tax community. This action items calls for the OECD to:

> 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. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive

94. For one proposal that takes into account the second-best properties of this option, see Stephen E. Shay, *Modernizing U.S. CFC Rules: A Minimum Tax to Limit Deferral*, 16 FLA. TAX REV. (forthcoming 2014) (proposing a minimum interim tax that effectively limits the benefits of deferral for low-taxed foreign income with the view of ameliorating pressure on MNEs to retain excess earnings abroad).

> and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules.[95]

Much like the former action item, action item four seems to aim—at most—at developing best practices. Limitations on the deduction of interest expenses are naturally a matter for domestic laws in practice. Tax treaties generally refrain from regulating the deductions side of tax laws. Originally focused on elimination of double taxation and facilitation of exchanges of information, tax treaties leave the design of tax bases to the relevant domestic laws. Moreover, the general deductibility rules are quite universal and straightforward within the income tax world. They all generally follow the matching principle—the matching of an expense with income it is intended to generate—and a tracing norm.[96] Therefore, little dispute has arisen regarding the fundamentals of the deductions rules.

The various limitations imposed by different countries' domestic laws on such deductions are much less universal, yet again, they are perceived as part of countries' domestic anti-abuse rules—the differences among which are to be tolerated on principle.[97] Economic double taxation or non-taxation may result, yet there is little agreement on how to handle that issue,[98] and tax treaties are generally unconcerned with deductions beyond tangential issues.

Nonetheless, the BEPS project has exposed the extent of use of interest expense tax planning by MNEs.[99] United States MNEs heavily employ interest expense tax planning strategies, primarily through related party financing arrangements and the use of derivatives and other sophisticated financing transactions. This discussion shall separate these two strategies. First, United States' interest expense allocation strategies

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95. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 4, at 17.

96. The most notable exception is the United States' interest expense allocation rules. Reg. § 1.861-9T. Note that R&D expenses enjoy a more universal benefit that overrules tracing due to the belief in the desirability of R&D.

97. *See, e.g.*, OECD, Commentary, *supra* note 20, art. 1, ¶¶ 9.2, 22.1.

98. For a comprehensive and critical review of both existing and potentially available methods to address debt finance issues, see Chloe Burnett, *IntraGroup Debt at the Crossroads: Stand Alone Versus Worldwide Approach*, 6 WORLD TAX J. 1 (2014) (assessing the pros and cons of the various options—especially the pros and cons of a worldwide approach versus a fixed ratio rule of some kind, finding the former superior. The analysis—done in the context of the BEPS project and action item 4 of the action plan—notes—similarly to this Article—that such a solution is also more compatible with the multilateral approach that is consistent with the BEPS project principles).

99. OECD, ADDRESSING BASE EROSION AND PROFIT SHIFTING, *supra* note 10.

generally wish to "import" deductions, that is, allocate them against the taxpayer's domestic source income. At the most rudimentary level, it allows a taxpayer to reduce current domestic income, which is usually highly taxed. Second, it usually increases the ratio of foreign source income for the taxpayer and increases the ability to "absorb" foreign taxes.[100] Note that such domestic tax base erosion is not generally disallowed. It is solely limited to arm's length interest transactions, to nonexcessive leveraging—due to the divergent thin capitalization rules applied domestically, yet very differently, by most countries—and, in some cases, by specific, yet limited, rules.[101] The BEPS project concludes that these limitations have been ineffective or inadequate.

Yet despite this complicated picture and the divergent norms, this is—as already mentioned—perhaps the most actively promising action item. The hope is that countries will be able to agree on coordinated solutions that are the hallmark of the BEPS project. These solutions would occur despite the question of the utility and sense of such convergence of rules. One can note this in the language that calls for coordination of this action item's deliverables with those of the former CFC action item—where one cannot find language calling for coordination with this item. Indeed, interest expense shifting strategies may augment the impact of deferral strategies, yet—as already mentioned—it is not clear how problematic interest expense shifting strategies are. The symbolism of reaching consensus on a converged and coordinated norm is important, being consistent with the first principle of BEPS, yet the magnitude of its real impact is unclear. It may even be the case that the BEPS project will need a symbol—a single coordination success story, the importance of which cannot be discounted because it will demonstrate the falsity of the argument that it is not realistic to expect countries to steer away from maximal tax competition.

It is unclear at this time what will be the destiny of the related issue of derivatives and other financially innovative transactions that do not seem to be on the agenda of the OECD.[102] It is likely that most of the BEPS-related discussion concerning these will take place within the discussion of hybrids under action item two.

In conclusion, despite the careful language of this action item that takes a conservative approach leading to perfection of best practices at the domestic level, it seems that in this context such best practices must include

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100. *See, e.g.*, Compaq v. Commissioner, 277 F.3d 778 (5th Cir. 2001), *rev'g* 113 T.C. 214 (1999).

101. The United States provides an example for the third instance because it uses an assets-based formulary interest expense allocation norm. Reg. § 1.861-9T.

102. Beyond the BEPS project, however, see OECD, AGGRESSIVE TAX PLANNING BASED ON AFTER TAX HEDGING (2013), http://www.oecd.org/ctp/aggressive/after_tax_hedging_report.pdf.

actual solutions on which countries would be expected to converge. This gives *de facto* hope that would mean countries were reaching for a coordinated approach of some power—consistently with the first principle of BEPS. Moreover, the lack of success of most relevant domestic anti-abuse rules to date, combined with rumor about the solutions contemplated by the OECD, lead to a reasonable expectation that the OECD will consider innovative—or less used—mechanisms here. This is consistent with the third principle of BEPS. Interestingly, the United States uses an unconventional, formulary norm for interest expense allocation.[103] The question is whether the OECD will be willing to go in that direction because formulary apportionment has long been within the OECD's "blind spot."

4. Action Item 6 ("Prevent Treaty Abuse")

Action item six may be categorized in the former section as a general, overarching action item due to its nature, referring to tax treaties as a whole rather than to a specific set of norms. Yet this Article places this action item within this section because it concerns a set of rules that are not included elsewhere in the action plan. Moreover, the general understanding in the tax community is that action item six will likely focus on a very specific set of rather familiar norms, despite its more general scope applying to the entire tax treaties sphere. The action item mandates the OECD to:

> Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to 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 co-ordinated with the work on hybrids.[104]

Preventing treaty abuse was not specifically identified in the OECD's initial BEPS report. The competition-based nature of the international tax regime led to significant ignoring of this notion. In the United States, tax treaties play a diminished role. This diminished role led one of the top tax treaty experts to reject the idea of treaty abuse by means of

103. *See supra* note 101 and accompanying text.

104. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 6, at 19.

arbitrage.[105] Elsewhere, tests have been developed to prevent the "improper use of treaties"[106]—an obviously softer language than abuse and avoidance.

In any event, treaty abuse generally has been considered a domestic law issue. It has been tackled with mechanisms such as the controversial beneficial ownership concept,[107] specific treaty anti-abuse rules in domestic law,[108] and specific treaty-based provisions. The latter included, limited ad-hoc "subject to tax" clauses, switchover mechanisms, and limitation on benefits ("LOB")[109] provisions that indirectly serve as specific treaty anti-abuse mechanisms.[110] Little convergence has developed for these measures, even among OECD countries. The language of action item six charges the OECD with promoting convergence—it seems—developing best practices in the use of the various measures.

Awkwardly, the BEPS project states—with concern—that the bilateral structure of the international tax regime has lost its integrity. The action plan expresses dismay about the use of "third party structures"—presumably the use of entities that are residents in countries where there is little economic justification other than tax for such use—and about the use of multiple layers between residence and source—again, presumably unjustifiably. More specifically, the report identifies as problematic the low-taxed foreign branches, the use of conduit companies, and the artificial shifting of income through transfer pricing. The suggested response is to

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105. H. David Rosenbloom, *The David R. Tillinghast Lecture: International Tax Arbitrage and the "International Tax System,"* 53 TAX L. REV. 137, 164 (2000) (discussing Tillinghast's lecture delivered on October 1, 1998).

106. *See, e.g.*, STEF VAN WEEGHEL, THE IMPROPER USE OF TAX TREATIES: WITH PARTICULAR REFERENCE TO THE NETHERLANDS AND THE UNITED STATES (1998) [hereinafter VAN WEEGHEL, IMPROPER USE]; PHILIP BAKER, IMPROPER USE OF TAX TREATIES, TAX AVOIDANCE AND TAX EVASION (2013), http://www.un.org/esa/ffd/tax/2013TMTTAN/Paper9A_Baker.pdf.

107. This is a defunct concept; a historical mistake that exists in tax treaties merely due to the insistence of tax authorities to hang on to it, believing it to be a weapon in their anti-abuse arsenal. For a comprehensive recent review and analysis of the concept and its use, see, for example, IBFD, BENEFICIAL OWNERSHIP: RECENT TRENDS (Michael Lang et al. eds., IBFD 2013) [hereinafter IBFD, BENEFICIAL OWNERSHIP].

108. *See, e.g.*, I.R.C. § 894(c) (United States' domestic rule denying treaty benefits for certain payments effected through reverse hybrid entities).

109. For a detailed technical analysis of the provisions, see, for example, Howard J. Levine & Michael J. Miller, *U.S. Income Tax Treaties—The Limitation on Benefits Article*, 936-1 TAX MGMT. PORT. (BNA) (2013). For a recent critique, see, for example, J. Clifton Fleming, Jr., *Searching for the Uncertain Rationale Underlying the US Treasury's Anti-treaty Shopping Policy*, 40 INTERTAX 245 (2012) [hereinafter Fleming, *Uncertain Rationale*].

110. For a more comprehensive review and analysis of these mechanisms, see, for example, VAN WEEGHEL, IMPROPER USE, *supra* note 106.

more closely align the allocation of income with the economic activity that generates that income.

The test of the BEPS project will be its ability to stay consistent with its fundamental principles. The easy way out would be to continue to evaluate domestic, ad hoc solutions rather than to emphasize principles. Such solutions have been tried—repeatedly—with little success.[111] Other solutions—such as "subject to" tax clauses—may be contrary to the policies and interests of some countries, and therefore are unlikely to work absent a multilateral agreement of some sort. Yet it should be apparent that the BEPS project is the forum for that; it is the best opportunity presented to date for progress on the multilateral agreement front. Finally, some solutions—such as LOB clauses—are limited in scope as they address limited abuses of the residence concept. Note also that the content of LOB clauses—even in the United States—is unsettled and partially controversial.[112] It would be disappointing if this action item resulted in a set of recommendations to simply universally adopt these rules. However, if a multilateral initiative considered some specific solutions, and, maybe more importantly, encouraged and also considered innovative solutions, the BEPS project could declare progress. That progress would also be consistent with the first and third principles of BEPS.

A more realistic achievement—and one that has rather strong support in the BEPS project developments to date—is the potential clear articulation of double non-taxation as a core principle of the international tax regime in general and tax treaties in particular. The BEPS report and action plan include perhaps the strongest double non-taxation language generated to date by the OECD. Elevation of the single tax principle to a superior status would be helpful in the interpretation of many treaty conflicts—regardless of the outcome of the BEPS project. Moreover, arbitrary measures dressed like domestic anti-abuse rules may now be challenged against a clear principle—a mechanism that is missing at the present. This action would be consistent with all three fundamental principles of BEPS.

Finally, 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 emphasized from the beginning and not bilateralism as such. This does not mean that only an all-or-nothing multilateral treaty will do. It may take time for such a treaty to materialize—if at all—yet the designing of current progress with a view of

111. Tax authorities even cling to beneficial ownership. *See, e.g.*, Jakob Bundgaard, *The Notion of Beneficial Ownership in Danish Tax Law: The Creation of a New Legal Order with Uncertainty as a Companion*, *in* IBFD, BENEFICIAL OWNERSHIP, *supra* note 107, at 91.

112. *See, e.g.*, Fleming, *Uncertain Rationale*, *supra* note 109.

the final goal will make such design more effective and less likely to be destructive in the process of reaching a multilateral tax treaty of any sort. Note that action item 15 makes the quest for a multilateral tax instrument an explicit goal of the BEPS project.[113]

5. Action Item 7 ("Prevent the Artificial Avoidance of PE Status")

This is an interesting action item. It deals with a reform of the international tax regime rules applicable to business income—perhaps the most important aspect and the key fuel of cross-border investment. These rules provide that only meaningful presence of business conducted by a nonresident would trigger taxation by the source country—where the business is conducted. They establish a PE threshold to determine the instances when business would be considered meaningful enough to trigger source taxation. Revision of the PE definition rules[114] and of the operative attribution of profits to PE rules[115] has been a constant on the OECD's agenda in recent times—unrelated to BEPS.[116] Overall, the trend in the OECD has been to elevate the PE threshold, seeking to maximize residence rather than source taxation. At the same time, this revision faced criticism, primarily from emerging economies, such as India and China. These emerging economies sought an opposite movement: lowering the PE threshold to expand source taxation. Against this background, the OECD is charged by the action item to "[d]evelop 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 will also address related profit attribution issues."[117]

The language of this action item does not reveal the significant work already done by the OECD on PEs. It seems very narrow and limited to BEPS-related threats—only two of which are mentioned: the use of commissionaire arrangements and specific activity exemptions.

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113. Note that gradual or even partial convergence is possible and could be useful. *See* Brauner, *Crystallization*, *supra* note 17.

114. 2010 OECD MODEL TAX CONVENTION art. 5.

115. *Id.* art. 7.

116. For the most recent examples, see OECD, OECD MODEL TAX CONVENTION: REVISED PROPOSALS CONCERNING THE INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT) (2012-2013) [hereinafter OECD, ARTICLE 5 PROPOSALS]; and the 2010 OECD MODEL TAX CONVENTION art. 7 and commentary.

117. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 7, at 19.

Yet the OECD chose to put the major Article 5 project on hold and gave preference to the BEPS project; this decision hints that the OECD clearly views this action item as having a wider scope than its language reveals.[118]

The issues specifically identified in this action item are: (I) Commissionaire arrangements—countries interpret the agency PE rules so that sale of goods may be negotiated without source taxation, leading MNEs to replace source state distributors with commissionaire arrangements that permit this interpretation with little to no real change in operations;[119] and (II) MNEs artificially fragment their operations among multiple group entities to ameliorate the meaningfulness of each, and to qualify for the "preparatory and ancillary" exceptions to PE status.[120] Note that the OECD identified very specific instances where it saw abuse, but only with respect to the technical elements of Article 5; Article 7 and the interaction between Articles 5 and 7—which may perhaps belong to the transfer pricing action items—were completely ignored. As was the case with the Authorized OECD Approach ("AOA"), the treaty side of the OECD—presumably working party 1—gives way to the transfer pricing side—working party 6—on the analysis of attribution of profits, as if the questions of status and attribution are independent of each other. This is the traditional view, yet it is problematic. A second immediate observation is that many of the issues that occupied the time and attention of the OECD's pre-BEPS project are not being addressed; these include the meaning of the "at the disposal of" language, the use of subcontractors, the time requirements, the presence of foreign personnel in the host country, the meaning of place of management, the "to conclude contracts in the name of the enterprise" language, the entrepreneurial risks, and more.[121] Finally, despite the contribution of political pressure by developing and emerging economies that led to the BEPS project, there is little attention to the main sources of complaints by such countries against the current design of the PE regime by the OECD. The action item does follow a general direction of protecting source taxation, yet it does not address the specific issues that countries such as India and China

118. *See, e.g.*, Stephanie Soon Johnston, *OECD's Final Work on Permanent Establishments on Hold for BEPS, Official Says*, 2013 WTD 108-3 (June 2013).

119. *See, e.g.*, *In re Boston Scientific, Cass., sez. cinque, 9 marzo 2012, n. 3769 (It.), unofficial translation at 2012 WTD 72-18;* Société Zimmer Limited v. Ministère de L'Economie, des Finances and et de l'Industrie, Conseil d'État [CE] [supreme administrative court], Mar. 31, 2010, Rec. Lebon 304715 & 308525 (Fr.); *Dell Prods. v. Skatt Øst*, ref 10-032855ASD-BORG/03 (Nor.).

120. Revision of the "preparatory and ancillary" language was part of the now-suspended work on Article 5 conducted by the OECD. *See* OECD, ARTICLE 5 PROPOSALS, *supra* note 116.

121. *Id.*

have been raising in the last few years. There is no consideration of the service PE concept, no discussion of changes to construction PE rules, no mention of the digital PE option—although that mention may come up in action item one, which is more generally devoted to the challenges posed by the digital economy[122]—and, finally, no reevaluation of the agency—or the subsidiary—PE concept as a whole.

In conclusion, the challenge faced by the OECD in this action item is somewhat different than what it faces elsewhere. The immediate triggers of BEPS did not involve significant abuse of the PE rules, yet certain aspects of these rules—particularly the agency PE and the service PE versions—triggered much controversy and destabilized the international tax regime. The key principle of BEPS in play here should be the second principle that requires a holistic approach to tax reform. As always, an inclusive, collaborative effort presents the best chance of success—more so than anywhere in this case where the primary complaint comes from G20 leaders that are not OECD members. The test of the BEPS project in this context would be whether it comprehensively revises the business income rules or merely patches up only the wounds affected by the most conspicuous thorns.

C. Transfer Pricing

1. Action Items 8–10 ("Assure that Transfer Pricing Outcomes Are in Line With Value Creation")

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. The essence of these transactions was the ability to "move" intangibles away from the United States and its high-tax jurisdiction to a low-tax jurisdiction. The basic intuition was to exploit United States-originated intangibles outside the jurisdiction by carving out the compound of rights and to prevent the United States from taxing income generated by these rights. In the past, United States' legislators and regulators had contemplated such exportation of property in general and intangible property in particular. They responded with several rules that clarified their disapproval of the legitimacy of such tax planning and attempted to shut down the opportunities to effectuate it.[123] When this action made exportation very difficult, taxpayers resorted to a scheme that used cost sharing to effectively export the abovementioned foreign rights in

122. Although indication has recently been received that the United States will oppose a digital PE rule. *See* Sheppard, *The Digital Economy*, *supra* note 49.

123. Two well-known examples are the super-royalty rule of Code section 367(d) and the "commensurate with income" language added to section 482 in the 1980s to explicitly eliminate the benefits of intangibles exportation.

their intangibles to low-tax jurisdictions—primarily Ireland, but also Luxembourg and other known jurisdictions. Cost sharing is a safe-harbor regime that shields qualified taxpayers from regulatory scrutiny, primarily from the application of the United States' partnership taxation rules and the normal transfer pricing rules.[124] Cost sharing is still a regime unique to the United States' transfer pricing rules, both in its scope and its "generosity" to taxpayers. Its origins and purpose are unclear,[125] yet its effect is enormous, allowing thousands of United States MNEs to avoid repatriation and tax payment on trillions of dollars of their foreign profits.[126]

Once these intangibles were parked in the low-tax jurisdiction, the MNEs would structure their business worldwide in a manner that would maximize the profits shifted to these low-tax jurisdictions at the expense of the countries where they operated using multiple schemes.[127] These are the notorious BEPS schemes that are now exposed through the BEPS project and related media exposure. These sophisticated tax-planning schemes all rely on the simple use of transfer pricing—the cost sharing opportunity and the bias inherent in the arm's length-based rules in favor of MNEs. This bias is particularly pronounced for MNEs with a larger intangible component in their businesses.[128]

Indeed, the insufficiency of current transfer pricing rules regulating intangibles has been acknowledged by the OECD and was acted upon prior to the BEPS project.[129] Unlike the PE project, this project seems not to have been shelved for BEPS. This is probably a positive sign because intangibles are at the heart of the BEPS issue, and proper transfer pricing treatment of intangibles should not be different for BEPS purposes or for the perhaps more limited OECD purposes—the challenge is the same. Appropriately, action item eight ("Intangibles") is the first transfer pricing action item:

> Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the

124. For a more detailed explanation of this regime, see Brauner, *Cost Sharing*, *supra* note 77.

125. *See, e.g.*, *id.*

126. *See, e.g.*, J.P. MORGAN & CO., NORTH AMERICAN EQUITY RESEARCH, U.S. EQUITY STRATEGY FLASH (2011) (stating a $1.4 trillion figure in 2011).

127. *See, e.g.*, the transactions described *supra* notes 2–3; Kleinbard, *Stateless Income*, *supra* note 90.

128. *See, e.g.*, Brauner, *Value*, *supra* note 5.

129. The OECD published a discussion draft first in June 2012, and a revised draft in July 2013. *See* OECD, DISCUSSION DRAFT ON TRANSFER PRICING ASPECTS OF INTANGIBLES (2012); OECD, REVISED DISCUSSION DRAFT ON TRANSFER PRICING ASPECTS OF INTANGIBLES (2013).

> transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.[130]

The intimate relationship between the intangibles and BEPS projects obviously makes sense and the same experts will—and should—work on both. Yet, responding to the intangibles challenge is perhaps the most difficult test of the BEPS project and of the consistency of the action plan deliverables with the project's fundamental principles. Most critical would be the adherence to the third principle of BEPS: being willing to consider an overhaul of current rules and an adoption of innovative solutions. In this context it primarily means allowing for formulary elements to be considered, beyond the arm's length rhetoric. This is the elephant in the room that has unfortunately fallen into the OECD's "blind spot." Here, the language of the action items does show promise: it admits that there are "hard-to-value intangibles," which means intangibles that the current arm's length-based transfer pricing regime is unable to regulate. Moreover, the action plan accepts the possibility of adopting measures "beyond" arm's length to measure intangibles, among others.[131] It clearly refuses to accept consideration of a replacement for the arm's length-based system, yet the above openness must signal a step in the right direction. To complete this picture, the intangibles project already seems to have leaned towards accepting a more central role for a profit split methodology that is already formulary to a large extent, and there is a serious consideration of safe harbors to further simplify the rules and increase legal certainty.[132] This is clearly consistent with the third principle of BEPS, yet of course the question is how far the OECD will go. Most importantly, a clarification that arm's length is the means rather than the end of the transfer pricing rules—either explicitly or indirectly through the adoption of measures "beyond" arm's length—should immensely contribute to a regime that has suffered from confusion due primarily to the incoherence of its principles.[133]

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130. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 8, at 20.

131. *Id.* Action 7, at 20.

132. *See, e.g.*, Isabel Verlinden & Vivienne Junzhao Ong, *News Analysis: The OECD Project on Intangibles—Reflections on the Public Consultation*, 2012 WTD 227-3 (Nov. 26, 2012) (reporting comments of the business community to the OECD intangibles work and stating: "The business community believes the intangibles draft has a bias toward the application of the profit-split methods.").

133. A great example for this confusion is the United States *Xilinx* saga. *See* Brauner, *Cost Sharing*, *supra* note 77, at 561–63 (describing the case, including the extraordinary vacation of the decision in the first appeal and its eventual reversal all

Related—and equally important—it seems that the OECD is clearly promoting the principle of ensuring that the transfer-pricing outcome be "in line with value creation." This principle is rudimentary, yet one can work with it. This principle may not be easy to implement because it is apparently inconsistent with some other language and current rules. Yet, it is clear and it should be widely perceived as fair, and thus legitimate. If this principle achieves legitimacy and acceptance, the work on implementation may have a chance of success, regardless of the means. It is further consistent with the second principle of BEPS and the holistic approach because such an approach must be based on a sensible principle rather than on constant ad hoc putting out of fires. The OECD must now clarify this principle and hope for acceptance.

This, however, may prove difficult. For example, when an intangible is completely designed and perfected in one country but is solely exploited in a second country, where is value created—in the first or second? And if it is created, how should the two jurisdictions split the value creation? Obviously, straightforward arm's length is helpless when this is done within a single firm, and the same problems that exist today are repeated. Yet the principle may be useful to get rid of some issues, such as the question of whether the workforce in place is relevant for transfer pricing study.[134]

Finally, the first principle of BEPS should also be satisfied in the work on intangibles. It is the implementation of the rules, even if revised, that would be key to their success. It simply has no chance of success without enhanced collaboration in assessment and enforcement. Take, for example, the so-called hard-to-measure intangibles—clearly the most important challenge faced. It has been demonstrated elsewhere that partial reform is possible and useful, even if it means that formulary elements are only allowed for these intangibles—which seems to be the minimal position of the action plan.[135] The risk is that if enhanced coordination is not included in the reform, it would be bent and refitted into the arm's length world, much in the same way that profit split and other nontraditional arm's length methods were. Formulary solutions more visibly mandate coordination of

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in the name of arm's length as the end, rather than the means, of the transfer pricing rules).

134. The OECD is currently reluctant to accept this, yet it clearly creates value.

135. Such partial reform is not impossible, as demonstrated by Reuven Avi-Yonah & Ilan Benshalom, *Formulary Apportionment: Myths and Prospects—Promoting Better International Tax Policy and Utilizing the Misunderstood and Under-Theorized Formulary Alternative* (U. of Mich. L. & Econ., Empirical Legal Studies Center Paper No. 10-029, U. of Mich. Pub. Law Working Paper No. 221) (2010), http://ssrn.com/abstract=1693105.

assessment[136] because the same formula must symmetrically apply to both sides of the transaction. This, too, is in the spirit of the BEPS project and its first principle.

Reform would be beneficial to the OECD beyond the BEPS project, although that truly depends on political will. It would bring closer some of the BRICS countries whose complaints about the OECD transfer pricing practices topped their list of grievances. Inclusiveness is also necessary under the BEPS principles, especially if one recognizes it as having a scope beyond the OECD.

There are two technical points that require attention as well, although a comprehensive technical analysis is beyond the scope of this Article and should await a detailed proposal. First, the OECD—similarly to the current rules—lumps all intangibles together despite some very significant differences between them. Some of these differences result in different patterns of value creation. Consistent with the value creation centrality principle, it is expected that the deliverables would distinguish the different intangibles according to their unique relevant features, and not, for example, dismiss the consideration of workforce in place (as already discussed above) just because it is difficult to fit it into the simple intangibles paradigm and measurement methods.[137] Second, the mention of cost contribution arrangements ("CCA") by the action plan is particularly puzzling, although little discussion has been devoted to it. CCAs under the TPG are not akin to American cost sharing. The OECD should be extremely cautious not to fall into the trap of adopting rules similar to that of the United States. It is these rules primarily—as stressed above—that generated the most offensive transactions that led to the BEPS project.[138]

The next action item introduces two specific intangible elements that are difficult to use within the current paradigm. This is action item nine ("Risks and Capital"):

> Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work

136. This assessment is intellectually required also in the arm's length-based regime, yet it is ignored, except for the very weak application of Article 9 in tax treaties.

137. A formula could, of course, take the location of important workforce into account when appropriate.

138. *See also* Brauner, *Cost Sharing*, *supra* note 77.

> will be co-ordinated with the work on interest expense deductions and other financial payments.[139]

Capital is another Achilles heel of arm's length taxation because it is obvious that the circumstances of MNEs are fundamentally different from those of unrelated corporations, even when these corporations would engage in similar transactions. Related parties operate as a single economic unit, effectively capitalized as such, while unrelated companies obviously are separately and independently capitalized. The work on Article 7 has exposed this difficulty and there the OECD simply punted. It is difficult to see how the OECD could achieve progress here within the framework of literal arm's length.

Risk presents a trickier—yet not less difficult case—because it is a matter of legal creation completely controlled by the taxpayers, supposedly regardless of value creation. Yet, at the same time, one cannot ignore the contribution of risk taking to value creation. So long as the OECD adheres to this normative principle, it would have to take risk into account. The only way to align the principle with the rules would be to use proxies to risk taking, which again requires rethinking current methods and perhaps accepting innovations. That would be consistent with the first and third principles of BEPS.

Action item 10 takes the above action items a step forward by explicitly acknowledging that certain related party transactions can never take place on the market between unrelated parties, and thus do not conveniently fit the arm's length paradigm. Action item 10 ("Other High-Risk Transactions") reads:

> Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.[140]

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139. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 9, at 20.

140. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 10, at 20.

This action item largely follows and reinforces the conclusions of the above action items. It also demonstrates the struggle within the OECD on this matter. On one hand, this is essentially covered by action item eight, yet the OECD chose to separately emphasize the situations where literal arm's length does not make sense because there are no market comparables and none can occur. In that sense, nothing new is expected to come from this action item; although it does mention specifically profit split, it is mentioned as an honorable defeat solution to save face for the arm's length apologists.

The action item mentions, however, two additional matters that may be important. The purpose of the mention of recharacterization for transfer pricing purposes here is unclear. If this means encouragement of the use of legal constructs—such as analogy, etc.—to mold non-market transactions into the shape of market transactions solely for the purpose of applying traditional arm's length methods to them, then this comment raises concern. It is exactly this approach that has failed to date and requires reevaluation. Constant promises that "this time we will get it right" should not be accepted.

The third comment is much more focused and mentions specifically the base erosion payments that have caused BEPS and are viewed as problematic and inappropriately dealt with under the current regime. These payments involve primarily the relationship between the brain and mind of the firm and the rest of it. Their serious evaluation requires a better understanding of intangibles and related services and their fit in the current legal scheme that, for instance, heavily relies on ownership.[141] The problem that the OECD faces is not conceptually different or separate from the general policymaking for intangibles. Yet in this particular case there is an alternative course of action, even if it is temporary—which in fact may be necessary due to the tight timeline. That alternative is to ad hoc address particular items of income such as those mentioned. The political attention may allow the OECD to introduce technical fixes that would otherwise be difficult to pass. Of course, it would be desirable that such fixes take into account the larger picture and goals, and do not simply serve as another layer of obstruction to fortifying the hold of arm's length thinking on the international tax regime. Management fees, for example, never should be viewed as simple provision of services, which is often camouflaged with simple and minimal cost-plus margins. A true value-creation approach would acknowledge the contribution of management as the heart and mind of the firm. At the least, significant profit margin should be allocated to it, based on the value-creation logic and the relative immobility of the humans that

141. This is rather ill-fitting to describe the economic function of intangibles in general due to their cheap scalability and significant uncertainty and unpredictability. *See, e.g.*, Brauner, *Value*, *supra* note 5.

comprise such management. Whether one wishes to use profit-split rhetoric or a formula is a separate question that is beyond the scope of this Article.

Finally, the legal design of transfer pricing rules within the general structure of the international tax regime is awkward and undisciplined. An analysis of the reasons and history for this is a matter for separate study. Regardless, although it is almost generally accepted that tax treaties encompass commitment to arm's length-based transfer pricing—the details of which are a matter for domestic law—an essential consensus expects them to be compatible with the TPG. The actual treaty device is merely complimentary to this construction. Article 9 requires a loose obligation to respect a treaty partner's transfer pricing determinations. The levels of commitment here vary, yet they vary between loose and extremely weak. A principles approach that seems to be preferable—at least by a section of the OECD experts working on these issues—would require a significant revision of the architecture of the relevant rules, regardless of the content of the principle chosen.

2. Action Item 13 ("Re-examine Transfer Pricing Documentation")[142]

The high stakes debate within the OECD about the reform of the transfer pricing rules is not less heated when it turns to the reporting facet of transfer prices. The language of the action item is quite mellow in tone:

> Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into consideration the compliance costs for business. The rules to be developed will include a requirement that MNE's provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.[143]

Most of the language states the obvious and is much in line with the traditional approach to transfer pricing that gained some universality, even beyond the OECD. It encourages better contemporaneous documentation of the analysis that establishes the transfer pricing positions of taxpayers, and it

142. Located in the administrative part of OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, (action items 10–15) that this Article generally discusses in the next section, this action item focuses on information and reporting. Yet, it is discussed here as it is naturally complementary to the discussion of the substantive transfer-pricing rules.

143. *Id.* Action 13, at 23.

calls for a balance between the more general belief of the OECD orthodoxy in the maximization of information exchange as a cure-all for international tax challenges and the compliance cost of such information provision. Despite the utilitarian flavor of the language, the general rule is in fact to demand, report, and exchange all information that is clearly useful in tax audits, but not usually more than that. Simply perfecting the current failing paradigm would clearly be inconsistent with the BEPS project principles.

Two important innovations that may not be obvious from the language of the action plan—or the original BEPS report—but have been well-known as the expected key deliverables of action item 13 in the tax community are (1) the standardization of a core of transfer pricing–related information reporting and (2) the mandate of country-by-country reporting of MNE operations. These two deliverables were explicitly specified as such by a recent discussion draft released in this context.[144]

The discussion draft includes a recommendation to standardize a core transfer-pricing report that it calls the "master file," together with a "local file."[145] The master file will include all the obviously needed information about the overall structure and operations of the MNE, its intangibles and its financial and tax positions, and will be available to all of the countries where the MNE operates and which may have a tax claim over such MNE's income. The local file will include information about the relevant local entity or entities of the MNE, information about local transactions, and relevant financial information. This file will be available in a standard format, yet with localized information only, in each relevant jurisdiction. Then, each country may presumably be able to require additional reporting beyond the standard to complement the local file.

This is a very promising action by the OECD. It directly deals with the problem of divergence of transfer pricing reporting requirements in different countries that obscured the true tax positions of taxpayers and resulted in significant and unnecessary compliance costs to them. The standardization permits an honest collaborative effort by tax authorities to apportion tax jurisdictions among them based on an agreed-upon baseline rather than the competition that generates inefficient incentives for both taxpayers and tax authorities to obscure information. Further, standardization is amenable to inclusiveness; it is especially helpful for governments that are weak in comparison to MNE taxpayers and therefore may not alone be able to demand and enforce compliance at a sufficient level. Finally, standardization of this kind inherently enhances transparency and an honest

144. OECD, DISCUSSION DRAFT ON TRANSFER PRICING DOCUMENTATION AND CBC REPORTING (2014) [hereinafter OECD, DISCUSSION DRAFT] (released by the OECD's WP6 that is working on action item 13 with a request for public comments on the draft).

145. *See* templates in *id.* at 11–14.

and educated discussion of the information as it is, it being available to all countries. Such transparency is a condition to a fairer regime and a more efficient one, being consistent with its core principles, such as the single tax principle. It is also consistent with all three principles of BEPS: it is innovative, it is comprehensive, and it enhances collaboration rather than tax competition. Of course, it is likely that some taxpayers—especially the largest MNEs that are at the spotlight of BEPS—together with their home countries would wage war against this deliverable as they feel that they are winning the tax competition game.[146] Resisting such opposition would be a major test for the BEPS project.

The discussion draft also includes a recommendation to adopt country-by-country reporting, although it leaves open, and calls for public comments on, the desirable format—as part of the standard reporting mentioned above or in a separate document, for example—for such reporting.[147] Nonetheless, it adds a model template for country-by-country reporting as a separate file.[148]

This is a major achievement of the BEPS project. This Article is of the opinion that country-by-country reporting should be within the scope of action item 11 that discusses transparency more generally, because although much of the BEPS planning targeted is intertwined with transfer pricing planning, it includes other elements that could equally benefit from such reporting. Yet, for simplicity, the Article follows the action plan's order. If implemented, country-by-country reporting may be the single most important achievement of the so-called civil society involvement with international tax policy shaping.[149] The role of civil society—the public—has been neglected in the project itself and in the literature analyzing it, despite its crucial role in raising the awareness to BEPS. Country-by-country reporting is important not only for the substantive reasons of improving compliance and enforcement, but also for the important legitimacy benefits it brings with it. Restoring the confidence of the public in the international tax regime must be a key goal of the BEPS project, thus the importance of legitimacy. It is also consistent with the fundamental BEPS principles, being innovative,

146. *See, e.g.*, Lee Sheppard, *OECD BEPS Country-by-Country Reporting Is Too Burdensome, HMRC Official Says*, 2014 TAX NOTES TODAY 28-3 (Feb. 11, 2014) (quoting opposition expressed by a U.K. official to the discussion draft, claiming that it goes too far and requires reporting of information that is not obviously necessary for effective tax audits, which is very much in line with the traditional OECD competition-based approach as it is explained above).

147. OECD, DISCUSSION DRAFT, *supra* note 144, at 5–6.

148. *Id.* at 15–16.

149. See, for example, the relevant webpage on the Tax Justice Network website: http://www.taxjustice.net/topics/corporate-tax/country-by-country/ (last visited Mar. 26, 2014).

amenable to a collaborative approach, and helpful for a holistic and coherent reform with the inclusiveness and legitimacy it brings.

Yet to ensure these qualities, country-by-country reporting must also be publicly available. The action plan and the discussion draft are vague about it, yet there is overall resistance among both taxpayers and governments to public exposure of these reports. Transparency is therefore the most fragile element of the country-by-country reporting initiative. This Article argues that country-by-country reporting must be publicly available. Otherwise, it is almost certain to become ineffective as an enforcement mechanism and irrelevant for the important—yet often ignored—legitimacy purposes. Tax authorities are likely to argue that tax information should be kept confidential because otherwise desirable competition would be hindered and there would be incentive for taxpayers to cheat on their tax returns. The most popular argument in this regard is that detailed information may expose all of the key intangible information that makes MNEs what they are. Interestingly, the discussion draft does not resort to such slogans and calls solely to ensure "that there is no public disclosure of trade secrets [and] scientific secrets."[150] Yet it adds to this list for good measure the nondescript "or other confidential information."[151] The Article calls for the OECD to either eliminate this latter safety valve or explicitly assert that it is meant for very specific cases where the law otherwise substantively protects the confidentiality of the relevant information. A review of the country-by-country reporting template released by the discussion draft demonstrates that the aggregate-natured information mentioned on it could not affect the competitive position of taxpayers beyond its effect on the aggressiveness of their tax planning. In addition, tax authorities may make the even worse—and somewhat contradictory—claim that country-by-country reporting is altogether unnecessary because the tax authorities in the different countries already either have the rather minimal information it provides or have the means to obtain that information. This is necessarily untrue because with the information, BEPS would not be such a big problem. Even worse, if it is true, then governments have the information but have not acted on it. Of course, this argument completely ignores the public implications of transparent country-by-country reporting that would open it to public, media, and academic scrutiny.

Finally, country-by-country reporting may assist in the development of multilateral instruments. These instruments are currently handicapped by the partial information available, primarily due to the bilateral nature of the current international tax regime.

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150. OECD, DISCUSSION DRAFT, *supra* note 144, at 9.

151. *Id.*

D. Administrative and Compliance

Five primarily administrative action items support the substantive portion of the action plan—action items one through 10. They are about reporting, dispute resolution, and development of a multilateral treaty mechanism. Except for the latter, these are generally items that are already central to current tax treaty law. The key innovation of BEPS is the explicit inclusion of an action item on a multilateral instrument. The mere consideration of such a measure is almost revolutionary to the dominantly bilateral international tax regimes. This section discusses the less innovative elements of this part of the action plan, excluding action item 13 regarding transfer pricing documentation, which that is discussed with the other transfer pricing elements above—leaving action item 15 ("Develop a Multilateral Instrument") to be separately discussed in the next section.

1. Action Item 11 ("Establish Methodologies to Collect and Analyze Data on BEPS and the Actions to Address It")

This action item generally calls for transparency—which is a favorite among all—yet, interestingly, it also calls for ex-post analysis that promotes accountability, which is often disliked by political institutions. However, there is little "action," in this action item, as it calls for the OECD to:

> 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. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses.[152]

The OECD has traditionally pursued exchange of information as a panacea and the sole appropriate action for fighting tax evasion. The work on

152. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 11, at 21.

information exchange has been delegated to the global forum[153] and should probably affect the BEPS project only marginally. The specific call for the development of a research and accountability mechanism is praiseworthy and may be very important for the success of the BEPS project. The OECD made the effort to give concrete examples for data to be collected, and although it mentions the need to balance administrative costs and privacy issues, it does not refer to the latter as exceptions but rather as balancing factors. This may mean that the OECD is serious about installing this accountability mechanism. Accountability is a critical factor in the success of reforms in any field.[154] It may signal a serious commitment to reform on the part of the OECD. It is innovative and legitimacy promoting, so, as such, it is consistent with a more collaborative approach to reform and with the fundamental principles of BEPS.

2. Action Item 12 ("Require Taxpayers to Disclose Their Aggressive Tax Planning Arrangements")

Action item 12 is another transparency-promoting action item. Similar to action item 11, it is not truly an action item, but rather calls for a study and a report on the improvement of information collection. Yet action item 12 focuses on taxpayers, with the view to balance some of the information asymmetry between governments and taxpayers by requiring taxpayers to concede of some of this advantage they have. It calls for the OECD to:

> 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. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be co-ordinated with the

153. *See supra* note 58 and accompanying text.

154. For an interesting discussion of the importance of accountability in international reforms, see, for example, WILLIAM EASTERLY, THE WHITE MAN'S BURDEN: WHY THE WEST'S EFFORTS TO AID THE REST HAVE DONE SO MUCH ILL AND SO LITTLE GOOD 15–17 (2006) (explaining, with ample examples throughout the book, the importance of feedback and accountability mechanisms for the chance of success of development reforms).

> work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations.[155]

There is little background available about this action item, yet it seems as if the United States' experiences influenced it.[156] A comprehensive study of the effectiveness of such measures and their design is beyond the scope of this Article, particularly because this action item is not at the top of the agenda of the OECD at this time. One should however note that the United States' experiences with the reporting of tax shelter activities may not be as positive as believed. Further, the context is different because it is naturally simpler to identify reportable transactions pursuant to a specific and single legal regime than pursuant to general principles. Diverse and sporadic reporting may even exacerbate—rather than alleviate—BEPS, as it is likely that different countries would employ different rules on these very sensitive matters with differing commitments to, and success in, their enforcement. Such unilateral action was the target of the BEPS project in the first place. This risk may not be worthwhile, especially when the value of the reward is questionable. Further study—so long as it has cooperation and the goal of a multilateral arrangement in mind—may be useful.

3. Action Item 14 ("Make Dispute Resolution Mechanisms More Effective")

This dispute resolution action item calls for the OECD to "[d]evelop 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."[157] It is unclear what direction the OECD will take on this matter. It is true that were treaty dispute resolution better, BEPS would be negatively affected; yet it is difficult to see a significant direct causal link between BEPS and the current state of treaty dispute resolution. Nonetheless, it is important to have a dispute resolution action item because

155. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 12, at 22.

156. For the United States' rules, see, for example, Todd C. Simmens & James G. Hartford, *Reportable Transactions*, 648 TAX MGMT PORT. (BNA) (2013).

157. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 14, at 23.

dispute resolution is the most obvious platform for international collaboration on tax matters and this platform is already in place.[158]

The current dispute resolution paradigm—based on the well-known Mutual Agreement Procedure ("MAP")—is largely elective. The OECD has promoted mandatory arbitration to be added to MAP, with little, or perhaps slow, success to date.[159] The collaborative element may cause some prior options for reform of the MAP to resurface. One that comes to mind is the proposal to establish an independent tax treaties interpretation board that would free treaty interpretation from the rigid institutional constraints of the OECD without harming the stability of the international tax regime.[160] Such a board could also assist, perhaps in a nonmandatory fashion, in the resolution of difficult treaty disputes—especially when the implication may go beyond the specific facts. Such a solution is just one example of progress possible in consistency with the fundamental principles of BEPS.

E. Action Item 15 ("Develop a Multilateral Instrument")

Standing alone as the single clearly innovative action item of the BEPS project, action item 15 calls for the OECD to:

> 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.[161]

Success with this action item should be interpreted to success of the BEPS project regardless of the outcome of the other deliverables. A reasonable design of the project would necessarily require completion of

158. Through tax treaty provisions, such as Article 25 of the 2010 OECD Model Convention.

159. *See, e.g.*, Ehab Farah, *Mandatory Arbitration of International Tax Disputes: A Solution in Search of a Problem*, 9 FLA. TAX REV. 703 (2009) (providing a critical review of the OECD's push in favor of the inclusion of mandatory arbitration provisions in tax treaties).

160. *See* Kees van Raad, *International Coordination of Tax Treaty Interpretation and Application*, 29 INTERTAX 212 (2001).

161. OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 10, Action 14, at 23.

action item 15 prior to the work on all other action items because it would necessarily be inefficient to reform rules that may be incompatible with the framework of the system in which they would operate. Nonetheless, this is indeed necessary in light of BEPS's messy upbringing and the tight schedule. The timeframe also dictated the goal of this action item, designed to produce not a multilateral instrument but a report on how would one go about designing such an instrument. Yet, this Article supports the OECD's decision to proceed in this path rather than hasten the process and produce a multilateral instrument that could not work. Nonetheless, the OECD has two years to produce a report that will be readily and realistically implementable; any other result should be viewed as a grave failure.

It is impossible to argue, consistently with the first principle of BEPS, that a shift from a competition to a collaboration paradigm is inevitable, yet stick to a bilateral framework. The next step should be to design all other deliverables with a view of having a multilateral instrument rather than in mere compatibility to the current bilateral regime. The OECD should remember that tweaking bilateral arrangements for triangular cases, for example, has proven either insufficient or unsatisfactory, hence the BEPS project. Yet, as has been demonstrated throughout the above analysis, bad habits (and conservatism) die hard.

It is absolutely crucial that the group discussing action item 15 understands that multilateral arrangements and convergence do not have to be an all-or-nothing matter. The unique structure of the international tax regime permits gradual progress.[162] Yet, progress requires focus. This Article argues that such focus necessitates a forum for the discussion and assessment of multilateral tax ideas. The OECD should make the decision whether it is willing host such a forum as the most natural candidate for this job, despite its rather more limited focus as the rich countries' club. This should be desirable for such countries who suffer most from BEPS, and for the OECD as an institution. Other options include perhaps a more "modular" model rather than the OECD's rigid single format. The strength of the OECD model is not in its strict singularity but in the standardization and the accessibility it provided. These may be preserved, albeit in a different, more collaborative and multilateral format, and it seems that the OECD has adequately started the process toward such end.

IV. CONCLUSION

BEPS is an overwhelming project in its breadth; it seems to be about everything and nothing at the same time. It covers essentially the whole international tax regime on one hand, yet on the other hand it may be read as a narrow hole-gapping exercise directed at stopping the most aggressive tax

162. *See* Brauner, *Crystallization*, *supra* note 17.

planning schemes—schemes that triggered the attention to BEPS in the first place.[163] This Article argues that the OECD work and interim reports on BEPS—as well as the unprecedented attention to it by the media, civil society, and politicians—leave little doubt that a narrow reading of the BEPS charge, if it is interpreted into limited deliverables and minor revisions of the rules of the international tax regime, will signal a failure of the project.

Such failure will have grave implications: (I) it will further destabilize the international tax regime; (II) it will further weaken the OECD as the caretaker of the regime and the sole forum for international tax policy discourse; (III) it may renew the distrust among the developed and developing countries that are already engaged in collaborative projects—albeit in the fringes of the regime, such as in the global forum initiative; (IV) it may strengthen the disbelief in international policy cooperation with the consequence of increasing unilateralism and tax competition of the harmful kind that triggered the project in the first place;[164] and (V) it will deepen the distrust of the public in the fairness and legitimacy of the tax system. Thus the stakes are truly high for all of the parties involved.

This is interesting because 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. Nonetheless, the OECD and others have already studied the challenges presented by the project quite extensively in the more general context of international tax reform. The BEPS charge simply created the opportunity to expeditiously engage in such a reform. However, the opportunity dictated some limitations: the timeframe is very limited and the clientele is mixed—not only OECD members, but also the G20, some of whose members view themselves as leaders of additional developing countries. These limitations, together with the history of the OECD work on the international tax regime generated a puzzle over the exact goals of the BEPS project. Yet from the beginning, three fundamental instrumental principles for tax reform surfaced: (1) only collaboration among countries could succeed in tackling the BEPS challenges; (2) a comprehensive and holistic rather than an ad hoc approach to such challenges is required; and (3) there may be needed some innovations, or the acceptance of solutions that are not part of the traditional arsenal of tax policy measures.

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163. This seems to be the position of the United States. *See, e.g.*, *supra* notes 49–50.

164. This does not mean that the competition paradigm will win the day and policymakers will accordingly return to the perfection of such competition. The more likely scenario is that the stronger economies will cooperate in smaller groups at the inevitable expense of the weaker economies, global economic growth, and fairness.

These principles represent a laudable departure by the OECD from its trenched position defending the orthodoxy and conservatism that dominates the tax world. This Article studied the current work of the OECD on BEPS, together with educated speculation about the likely outcome of the first phase of the project. It then evaluated the compatibility of the work and the likely deliverables with the principles set by it. The result is mixed—as may have been expected.

The first principle of BEPS represents a major step forward for the OECD. The competitiveness paradigm is entrenched in all of the norms of the international tax regime and the regime lacks a mechanism to effectuate collaboration. There isn't even a forum where these issues may be discussed beyond the OECD, which has been reluctant to serve as the forum for universal tax policy reform. Yet the OECD has realized that unilateral action within a tax competition framework simply does not work, regardless of the wisdom or best intentions of each country's separate actions. The most important achievement of the BEPS project should be making progress towards a multilateral instrument, following up on the work done pursuant to action item 15. In the meantime, particular reforms should be designed with the view of being subjected to such an instrument. For example, the likely recommendations pursuant to action item two on the desirability of domestic specific anti-abuse mechanisms necessarily fit a competition rather than a collaboration paradigm, and thus are not compatible with a multilateral setting. Similarly, the resort to "best practices" guidance pursuant to action items three ("Strengthen CFC Rules") and four ("Limit Base Erosion via Interest Deductions and Other Financial Payments") is unlikely to fit a multilateral framework. At the same time, the establishment of principles in a manner new to the international tax regime shows significant promise. The explicit articulation of the single tax principle—although it could have been more forceful—is one example, and the principle that transfer pricing must correspond with value creation is another. Both have a bumpy road ahead, including some immediate political challenges and longer termed implementation challenges—as explained above—yet they represent a chance for the international tax regime to evolve and thrive in its new projected collaborative framework. Similarly, the standardization of transfer pricing documentation represents a similar approach on the procedural front, with the benefit of not only the obvious standardization but also its inclusiveness and transparency properties, which permits its application at any scale in a true multilateral fashion.

The second principle of BEPS—promoting a holistic approach to reform rather than ad hoc solutions to burning problems—is obviously related to the first principle. The standard transfer-pricing reporting just mentioned is one example of progress in this direction; the principled approach promised for the substantive transfer pricing for intangibles rules is another. Yet, there is still much to be desired in this context. The likely

response to hybrid mismatch arrangements pursuant to action item two—and similar ad hoc solutions proposed pursuant to action items three, four, and five, all relying on domestic anti-abuse mechanisms that are at most going to be guided by OECD best practices reports in the conservative fashion—is disappointing from this perspective. These responses demonstrate the difficulty of disposing of old habits, even as the response is made in the context of a project such as BEPS—which was clearly launched to reform them.

The third principle of BEPS is about innovation and openness to new ideas. This has been the primary weakness of a defensive OECD to date. Yet this aspect of the BEPS project provides the most promise. A key example of this *volte face* is the willingness to accept that intangibles present new challenges to the international tax regime and cannot be simply regulated by analogy to the traditional tangible property-focused rules. The dramatic acceptance of the need to go "beyond arm's length" will likely prove the single most powerful action against BEPS. Other notable examples include the mere willingness to consider a multilateral instrument rather than to confine the regime to its currently struggling bilateral format, country-by-country reporting, and safe harbor mechanisms in both the transfer pricing and debt financing action items.

In conclusion, the BEPS project presents a mix of promise and concern as it proceeds to reform the international tax regime. This Article points to some of the positive courses and warns of some potential slippery corners on the path. This Article's final contribution is to assess what are realistically the most important aspects of this analysis, so that the OECD can consider this Article's point of view while the window of opportunity for such consideration is still open and the project is not finalized. First and foremost, the project must produce "something" on action item 15 toward the development of a multilateral instrument and compatibility of the legal regime with the continuously globalizing marketplace. Second, transfer-pricing reform is the most immediate necessity because transfer-pricing planning is the hallmark of BEPS. Institutionalizing the value creation principle and pouring content to it through implementation rules will represent success. This should be done following the recognition of the unique characters of intangibles and the acceptance of new solutions—such as formulary apportionment, the use of safe harbors, and standardization of reporting. Third, some tangible deliverables should be produced in the shorter term. Reform of the debt financing and business taxation rules—including PE rules—and response to hybrid planning should be first in line. For the reform and response, the project should resist the temptation to resort to unilateral solutions—such as domestic anti-abuse norms—and to soft "best practices" guidance; rather the project should develop mechanisms compatible with the future multilateral, collaborative regime. Finally, the project should clearly recognize the fragility of the international tax regime

and the necessity of restoring public trust and wider legitimacy. A public country-by-country reporting scheme would be an excellent tool towards achieving this goal. Similarly, widening the scope of reform to include the interests of emerging and developing economies—for example, by expanding the discussion of business taxation beyond the two anecdotal issues mentioned in action item five—would send a clear signal about the BEPS project's sincerity about making the regime more inclusive, fairer, and truly multilateral.