International

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The Evolving World of Global Tax Planning: Part I

This article is the first in a series, which will review considerations that MNEs may want to take into account in adapting their strategies in this evolving world of global tax planning. The authors will address this vital topic in three instalments, namely (i) framing the background, (ii) anticipation of an ever-increasing agenda of disputes and (iii) the epochal opportunity for MNEs to retool their ETR planning strategies.

1. Introduction

In the global community, the reigning paradigm seems to be political chaos. News updates in all media channels declare the seemingly ever-deepening divides in the world – wars in the Middle East, tension between the West and Russia, economic malaise in China, territorial disputes in Asia, Colombian voter rejection of peace, Brexit and so on.

Turmoil also prevails in the global marketplace. Economic growth is stalled around the world, perhaps driven by uncertainty in the political world. With stagnant economic growth, there is political pressure to find means of boosting economic activity in each country and globally. A critical component of economic growth is domestic and foreign direct investment. Private sector investment decisions require promising forecast of return on investment, including tax expenses of the project in question. Stability in this regard is ideal. If there is fear of cross-border dispute or retroactive adjustment (via legislation or otherwise), forecasts may be rendered problematic, thereby undermining confidence and, as a consequence, willingness to invest or commit resources.

In other words, international taxation is a critical component of the political and economic global marketplace. For generations, the framework of global taxation was stable, emanating from the post-World War I treaty and transfer pricing framework established by the capital-exporting victors. This framework has been under challenge in recent years, producing uncertainty as to principles that will be applicable in future. For governments, there is anxiety that domestic tax bases may have been denuded by multinational enterprises' (MNEs) planning models developed in response to the longstanding framework. On the MNE side, there is concern about potential tax exposure from a repudiation of taxation models relied upon at the time prior investments were planned and implemented, as there is also optimism that new tax models may open interesting vistas of opportunity as regards the effective tax rate.

In the evolving international tax world, countries are actively defining how their domestic tax base can be maximized to provide revenue for economic progress, as MNEs are evaluating their effective tax rate planning strategies (ETR planning strategies) to address the changing world. This is an epochal process, reflecting a rather stunning transformation from all sides of the table. The authors describe this as epochal because the underlying foundational principles are evolving for the first time in almost a century, providing a unique opportunity for both countries and MNEs.

Opportunities for international tax planning are – and always have been – largely a consequence of navigating rules developed by countries for their own purposes (rather than anything MNEs have created on their accord). It is possible that little may actually come if countries ultimately decide to protect their own tax base at the expense of other countries, as has occurred in the past (such as the OECD harmful tax competition project).

While these changes are occurring globally, it is a voyage that has been undertaken in many contexts in the past. Learning from that experience should provide a beacon for MNE groups to chart the way forward to cope with the evolving world.

Regardless of how these processes evolve, it seems inevitable that controversy dockets at all levels are likely to continue to escalate in terms of sheer numbers as well as swelling inventory. It is to be hoped that global processes will evolve to provide meaningful relief for both countries and MNE groups.

This article is the first in a series, which will review considerations that MNEs may want to take into account in adapting their strategies in this evolving world. The authors will address this vital topic in three instalments, namely by (i) framing the background, (ii) expressing their anticipation of an ever-increasing agenda of disputes and (iii) outlining the epochal opportunity for MNEs to retool their ETR planning strategies.

2. Current Global Tax Environment

Epochal change in treaty, transfer pricing and related areas of international taxation is on the horizon. The G20 inspired project on base erosion and profit shifting project (BEPS) of the OECD was designed to rationalize perceived disparities in the international tax environment. The 15 BEPS Actions were finalized in late 2015.[1] These final

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1. *See* sec. 4. *See generally* C. Lowell, M. Martin & M. Levey, *International Transfer Pricing: OECD Guidelines* para. 2.08(2)(c) (Thomson Reuters 2016).

reports provide commentary and suggested guidance for means to address the issues in each area, including a multilateral instrument intended to achieve broad acceptance and resulting consistency.

Whether there is sufficient political will to push through some or all of the BEPS Actions will remain to be seen. In this regard, it has already become apparent that there are significant differences of view among countries – which will inevitably lead to problems in the application of tax treaties and transfer pricing principles for the allocation of income and resultant tax among countries. Some countries can be expected to modify certain of the BEPS Actions, as they ignore others, to suit their respective domestic policy imperatives, which may be far different than those of other countries or as anticipated in the BEPS Actions.[2] MNEs will need to navigate their ETR planning strategies through these waters.

2.1. Considerations to be taken into account

There are also other developments underway which will have – at least – equal impact, including the following (collectively, the Considerations):

- *historic model rejection:* Extant treaty, transfer pricing and related policies are being thoroughly reconsidered. All OECD countries, except the United States and a few others, have abandoned policies designed to attract global residual income to the residence country. Rather, they have adopted source-based regimes (such as a territorial tax);[3]
- *source country evolution:* Many countries are redefining tax principles appropriate to their own context (regardless of direction from global organizations). The so-called BRICS countries (Brazil, Russia, India, China and South Africa) can be viewed as essentially rejecting the OECD Model Convention (OECD Model) and transfer pricing principles, except when such principles benefit their domestic tax base.[4] The rise of the BRICS and other source countries has brought increasing pressure to bear on the OECD, which needs their acceptance and cooperation. Concessions can already be seen in the evolution of the OECD's thinking (for example, expansion of intangibles concepts to include so-called "soft" intangibles, goodwill, and related items);[5]
- *BEPS challenge:* The G8 and G20 have determined that global economic malaise is a result of ETR planning strategies. The OECD has pursued the BEPS project with wide-ranging suggestions for next steps in the BEPS final reports (2015),[6] which will be implemented in a manner yet to be determined – perhaps unilaterally, multilaterally or not at all in some countries;
- *BEPS and treaties:* Any material changes coming out of the BEPS Actions will need to be implemented through international treaties or domestic tax laws, perhaps including the anticipated BEPS multilateral instrument;
- *country-by-country data:* As a result of the BEPS Action on so-called country-by-country transfer pricing documentation (country-by-country reporting), fully transparent data is likely to be available to all or many tax authorities (and perhaps to the public);[7]
- *special measures:* The BEPS project raised the spectre of special provisions that could, in effect, impose penalties on planning strategies, along the lines of the spreading general anti-avoidance regimes. Accordingly, it will be appropriate to determine if any developments in ETR planning strategies with respect to function/risk could be subject to such attack;
- *automatic exchange of information:* Tax information will increasingly be shared between countries under the various bilateral processes included in the BEPS project or otherwise,[8] which will augment data flowing from country-by-country reporting and other sources;
- *profit split:* It will be increasingly common for examination proposals to be based on two-sided transfer pricing methodologies (profit splits) developed from the country-by-country reporting data;
- *intangibles evolution:* The OECD is also updating the intangibles elements of its Transfer Pricing Guidelines (OECD Guidelines);
- *EU trajectory – State aid:* Many MNEs have followed common planning paradigms over a long period of time which have often been blessed by rulings from pertinent countries. The current so-called "State aid" inquisition by the European Commission has generated uncertainty with respect to the propriety of such structures, framing fear of retroactive alteration of tax principles believed to be applicable to investment decisions.[9] Obtaining relief from a specific government (perhaps the home country of the MNE) may be an element, not the driver, of future planning;
- *unilateral regimes:* Specific countries may adopt sui generis policies intended to provide tax-efficient regimes to attract valuable economic activity and inward investment away from competing countries;[10]
- *exit tax:* Moving functions or risks from one country to another may trigger an additional layer of tax,

2. *See* sec. 6.3.
3. *See* sec. 3.2.
4. *See* sec. 6.1.
5. Lowell, Martin & Levey, *supra* n. 1, at para. 5.01(2).
6. *See* sec. 4.3.
7. *See* sec. 5.
8. Such as the Common Reporting Standard promulgated by G20 and OECD in 2014.
9. *See* sec. 6.2.
10. *See* sec. 6.3. *See Patently Problematic*, The Economist, at 53-54 (29 Aug. 2015) (describing the "beggar-thy-neighbour" policies being followed by certain G20 countries).

which may or may not be creditable or deductible elsewhere;[11]

- *digital economy:* This provides a different model of economic activity and base for competition (between countries and MNEs);[12] and
- *sovereignty:* All countries will continue to insist on their own sovereignty in terms of domestic tax policies, regardless of aspirations of the OECD, Civil Society, or other groups.

In the aggregate, the Considerations reflect the tax world's confronting all governments and MNEs, although, understandably, the frame of reference for each is distinct.

2.2. Taxation from the government perspective

Taxation is the wherewithal of public finance. The budget of each jurisdiction in which an MNE conducts business operations incurs expense for providing public services, such as safety, fire and police protection, roads, hospitals, national defence and education. The environment for doing business in a jurisdiction will largely be shaped by the extent to which a government succeeds in delivering these services. In other words, taxation provides finance for public services.

To protect and preserve its tax base, government at every level must define its tax system through appropriate legal declarations (often a legislative function), provide guidelines for the application thereof (often an administrative function) and enforce the laws and regulations (inevitably, an administrative function). This is true of both domestic and international business activities.

It is easy enough to declare as shibboleth that taxation from the government perspective is tax-base defence. But this is too simple when one considers international activities. In this context, it is necessary to enquire as to the identity of the persons against whom the domestic tax base needs to be defended. The answer is that a given government must defend its tax base against other governments, as well as taxpayers.

The tax base needs to be defended from other governments because there is an inevitable competition between governmental units for the attraction of business activities, which provide local employment, payroll, sales and payroll taxes, and related services – which, in turn, produce more payroll, sales, and property taxes, and so on. The result is a tax multiplier. This is why governments routinely provide significant economic incentives for companies to locate all or specific activities within their jurisdictions. In extreme instances, the incentives may simply transfer government budget items from welfare to the attraction of jobs, which in the long term will free up welfare funds for other uses. In other words, the international tax pie in the aggregate must inevitably be allocated between countries, which means that it can be a zero-sum process (i.e. what one country gains, others are likely to lose) if a premise is that taxpayers should not suffer double taxation. While this is certainly a simplistic point, it is important in assessing the realities of the international tax world.

A wide range of tax incentives is provided by developed as well as developing countries to expand their tax bases. There are also active efforts underway by all countries to attack perceived tax base erosion, whether from MNE planning schemes (the principal target of the BEPS Actions) or tax competition from tax havens or countries deemed to provide harmful tax regimes. At the same time, governments also undertake efforts to attract tax base away from other countries.[13]

2.3. Taxation from the MNE perspective

Tax-base defence also relates to taxpayers that have a fiduciary obligation to minimize expenses – a critical imperative of successful financial management of MNEs in the 2lst century. Resulting profit can be invested into new markets or new products. The strength of the enterprise will fuel growth in market capitalization and long-term survival.[14] Management and shareholders will, in turn, reap proportional financial benefits.

The first or second most significant expense for most companies is taxation. Taxes are imposed at all levels of government and on a crazy-quilt of transactions. Large or small in incremental proportion, the aggregate tax expense is dramatic. Accordingly, tax is a significant element of expenses that must be contained.

The ETR planning strategy will ultimately be a function primarily of three interrelated elements:
(1) the structure or arrangement of its activities, risks and functions;
(2) the allocation of income and expense among members of the enterprise; and
(3) the effective use of incentives from pertinent government policies, foreign tax credits, net operating losses and other tax attributes developed within the group.

As a fundamental building block of MNE tax containment, taxation is – to a large extent – a function of business decisions regarding where research, manufacturing, distribution, services and other functions are conducted, as well as the intercompany allocation of economic risk for the success or failure of respective operations (1). The allocation of income and expense among these activities (2) is, of course, simply transfer pricing. The final element (3) is that every group pays tax in certain countries, incurs losses in others, or has tax incentives for defined conduct in yet other jurisdictions.

In other words, ETR planning strategies are critical to an MNE's long-term competitive success. This has and will continue to be true in future. As will be discussed below,

11. Lowell, Martin & Levey, *supra* n. 1, at para. 12.02(2)(d) (OECD business restructuring).
12. Lowell, Martin & Levey, *supra* n. 1, at para. 9.08.
13. *See* sec. 6.3.
14. There have been studies of the relationship between effective tax rates and market capitalization. S.L. Mintz, *A Taxing Challenge*, 15 CFO Magazine 62 (1999); C.W. Swenson, *Increasing Stock Market Value by Reducing Effective Tax Rates*, California Tax Notes (7 June 1999).

prevailing MNE strategies were designed to take advantage of opportunities made available by domestic law, treaty provisions and transfer pricing principles.

In view of the Considerations, MNEs will exercise vigilance to assess their impact on existing ETR planning strategies, as they thoughtfully seek evolution to incrementally enhance the planning strategies in a cost-competitive environment. For each MNE, there are at least two questions to be addressed (the ETR questions), namely:
– what do the Considerations mean for the ETR planning strategy; and
– how can a taxpayer incrementally evolve its ETR planning strategy?

Before addressing these questions, it is appropriate to place the Considerations in a historic context to ascertain whether there is learning to be derived from the perspective of both countries and MNEs.[15]

3. Foundation of the International Tax Framework

A prominent element of the Considerations is the posture of countries vis-à-vis other countries. As suggested with respect to taxation from a government perspective, the allocation of taxation rights among countries can be viewed as a zero-sum game. Accordingly, the principles upon which countries have agreed to allocate tax revenues are a critical element of the overall environment. If there is broad agreement on such principles, there is at least theoretical harmony among countries, which should, in turn, facilitate the planning processes of MNEs. On the other hand, if there is disagreement on these principles, there is space for ETR planning strategies to chart an efficient and effective path that can be expected to generate disputes between and among governments and MNEs.

As reflected in the Considerations, there is increasing disagreement on these fundamental principles, which were established just after World War I (almost a century – or an epoch – ago). Accordingly, it is essential to understand that initial framework and why it has generated disharmony among governments.[16]

3.1. 1920s League of Nations model

The current OECD and UN Models are based on the concept that residual income should be allocated to the country of residence (residence country) of an MNE, as opposed to the country of source of the income (source country). Transfer pricing and other principles have evolved within this conceptual framework.

Perhaps the most fundamental issue of the present time in the international tax debates surrounding tax base allocation is the balance between residence and source taxation. This debate is evolving between source countries, on the one hand, and the OECD and UN on the other, with MNEs (the payers of tax to finance the budgets of all countries) in the middle. Some source countries have rejected the OECD/UN Model Convention concepts. Others have generally expressed support for the concepts, although their actual practice of transfer pricing and related issue enforcement suggests a different approach.

The essential issue is that source countries increasingly insist on taxing income based on the source of the underlying economic activity, not on the residence of the parent company (or interim holding company).[17] There are at least two essential explanations for this posture:
– the residence concept had, from its inception, a serious flaw. It did not take into account interim holding companies in low-tax jurisdictions; and
– the imposition of residence as an allocation criteria was largely a product of post-World War I international politics. The world has changed dramatically in the interim and former "colony" countries are now economic powerhouses.

As a result of these factors, many MNEs experience the following attitude of tax authorities in source countries: "If you want to do business in my country, you will pay tax on my terms. If you do not like my terms, do not come to my country; others will take your place".

The origins of the treaty and transfer pricing models can be traced to the work of the International Chamber of Commerce (ICC) and the League of Nations immediately following the cessation of hostilities in World War I, which ended in November 1918. At that time, all countries had crushing debt burdens and sought to impose tax wherever possible. The danger of double or multiple taxation was a significant concern of businesses and governments.

3.1.1. International Chamber of Commerce

The ICC was formed in Paris in 1919 to (i) promote trade and investment, (ii) promote open markets for goods and services, and (iii) facilitate the free flow of capital. One of the foundational elements of the ICC was the elimination of double taxation, as indicated in the following early resolution:

> RESOLVED, That the International Chamber of Commerce, in a meeting duly assembled, composed of representatives of commercial and industrial organizations of the allied countries [victors of World War I], urge prompt agreement between the Governments of the allied countries in order to avoid that individuals or companies of any one country may be liable to more than one tax on the same income, taking into consideration that the country to which […] such company belongs has the right to claim the difference between the tax paid and the home tax.[18]

The factual paradigm that was the focus of discussion in the post-World War I period was the "mercantilist" model, which was described at the time as follows:

> ImperialCo is incorporated and has its home office in England. The year is 1925. ImperialCo is in the textile business and requires

15. *See* secs. 5.-6.
16. The following discussion is drawn from B. Wells & C.H. Lowell, *Income Tax Treaty Policy in the 21st Century: Residence vs. Source*, 5 Colum. J. Tax L. 1 (2013).
17. L. Sheppard, *Transfer Pricing Rubric Questioned*, 135 Tax Notes 1561 (2012).
18. Quoted in Chambre de Commerce Internationale (ICC), Congrès de Londres 1921 (Brochures 1-16) (ICC Paris Archives) (1921 ICC Proceedings), Brochure 11, at 3. *See generally* M.J. Graetz & M.M. O'Hear, *The 'Original Intent' of US International Taxation*, 46 Duke L.J. 1021 (1997).

> a ready supply of cotton, a raw material not grown in England. ImperialCo has a global organizational structure with subsidiaries based within the cotton-producing British commonwealth countries, such as India. It also has manufacturing facilities in important commercial regions of the world (India and elsewhere), as well as shipping companies that transport raw materials and finished products to global commercial markets. All these operations are based in the colonies, with affiliates conducting business using capital and technology provided by ImperialCo. In return, the affiliates pay interest and royalties to ImperialCo, which are deducted for colony income tax purposes. To the extent that excess cash remains in colony affiliates after local expenses and taxes, such income is distributed to ImperialCo via dividends.[19]

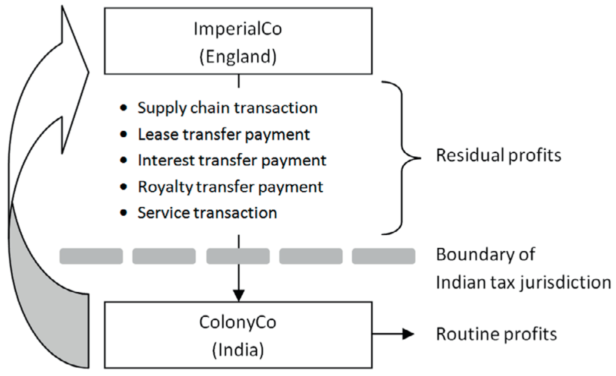
The framework of tax was based on the mercantilist belief that imperial countries were responsible for the provision of capital and know-how, while the colonies were passive suppliers of goods or services with little value added functionality. As a result, the right to tax residual income belonged to the residence country of the imperial companies (England, in this example). Source countries (here, India) were allowed to tax only routine profits deemed earned therein and impose withholding taxes on certain types of outbound payments.

ImperialCo's tax planning strategies in this mercantilist paradigm would likely be along the following lines:

> Raw materials (raw cotton) or processed goods would be purchased from the colony country company ("IndiaCo") at the lowest price possible consistent with providing IndiaCo the capital needed to continue operations ("supply chain transactions").
>
> Movable tangible property (machinery and equipment) could be leased by ImperialCo, with leasehold payments made by IndiaCo ("lease transfer payments").
>
> Capital could be provided via loans from ImperialCo, with interest payments made by IndiaCo ("interest transfer payments").
>
> Know-how to the extent required could be provided in the form of licenses with royalties paid by IndiaCo ("royalty transfer payments").
>
> Services provided by ImperialCo would be paid for via service fees ("service transactions").

The net result of these transactions is that ImperialCo would have the ability to transfer the residual profits out of India at a minimal Indian tax expense, leaving only routine operating profits in IndiaCo. The arrangement can be depicted as in Figure 1:[20]

Figure 1. Mercantilist paradigm example



The ICC focused on the double taxation issue as the League of Nations organized its own efforts.[21] The ICC's initial assembly, held in Paris in June 1920,[22] adopted a resolution that "Governments of the allied countries should speedily come to international agreements, in order to prevent … companies from being compelled to pay tax on the same income in more than one country".[23] The first ICC Congress was held in London from 27 June to 1 July 1921.[24] Double taxation was one of the first subjects addressed by the ICC.[25] The ICC considered a set of principles that were debated and ultimately revised.[26]

The Second Congress was held in Rome in 1923. The proceedings noted that additional meetings had been held in the interim, including contacts with the Fiscal Committee of the League of Nations.[27] In these early discussions, the bedrock principle was that where a company does business in more than one country:

- the profits should be taxed in each country in proportion to the profit realized therein (paragraph 8 of the ICC draft 1923 resolution);[28]
- if the countries cannot agree, the allocation would be presumed to be proportional to sales (turnover) (paragraph 9 of the ICC draft 1923 resolution);[29] and
- however, in no case should such proportions exceed the total fixed by the "competent authority in the country of domicile" (residence) (paragraph 10 of the ICC draft 1923 resolution).[30]

In other words, the ICC recognized that the combined income of the enterprise would need to be allocated ultimately on the basis of proportional sales if the countries could not otherwise agree, subject to agreement by the residence country (domicile).

In the discussion of the proposed resolutions, it was recognized that the fundamental problem was the creation of separate fiscal regimes in each country. While the problem could be resolved by the introduction of uniform tax law, this was renounced as "utopian".[31] The principle to be

19. The following hypothetical is adapted from M.B. Carroll, *Methods of Allocating Taxable Income*, League of Nations Document C.425(b).M.217(b).1933.II.A., 4 Taxation of Foreign and National Enterprises 22-23 (1933) (giving an example of cotton and other goods produced in India to be sold abroad).
20. This chart is from Wells & Lowell, *supra* n. 16.
21. There was contact between the ICC and the League, including overlapping membership in the double taxation committees. *Double Taxation (Survey of the Work of the I.C.C. Since the Rome Congress)*, Brochure 34, at 10 (Brussels Third Congress, 21-27 June 1925) (1925 ICC Proceedings).
22. *Business Men Go Abroad*, NY Times (6 June 1920).
23. ICC, Second Congress (Rome, 18-25 Mar. 1923), Brochure 25, at 14 (1923 ICC Proceedings).
24. The proceedings are contained in the 1921 ICC Proceedings. Contemporaneous news accounts explained the significance of the meetings. *See Favor World Board to Facilitate Trade*, NY Times (20 June 1921) (attendees to create "a permanent International Committee charged with ironing our difficulties arising in the exchange of goods between nationals of different countries").
25. 1921 ICC Proceedings, Brochure 11 (Part I), at 3.
26. Id., at 4.
27. 1923 ICC Proceedings, Brochure 25, at 16.
28. *Programme of the Congress and Draft Resolutions*, 1923 ICC Proceedings, Brochure 23, at 34-35.
29. 1923 ICC Proceedings, at 34-35.
30. Id.
31. 1923 ICC Proceedings, Brochure 25, at 8.

observed was that income should be only taxed once. The issue, then, was to determine "what constitutes the right of one country to tax the income of a tax payer in preference to any other country".[32] The following statement at the time framed the issue well:

> It does not seem probable that there would be serious difference of opinion on this matter. A wide-spread view considers that the country from whose territories the income is derived should in every case have the right to levy a tax thereon. At the same time it is agreed that as regards income derived elsewhere, the country of domicile should have the privileged position.[33]

As indicated from the above excerpt, the ICC contemplated that a system of credits be established between countries, except that no country would be expected to give up, via foreign tax credit relief, more than "half the amount that it could have gained had the income been derived from its own territory".[34] The delegates contemplated that if these principles were accepted by countries under the auspices of the League of Nations, the principles would be included in the national laws of the countries.[35] In addition, it was hoped that a set of regulations would be developed by an "international fiscal commission", along with the availability of an administrative appeal in the country or by an international commission with national or international court or arbitration review.[36]

In the 1923 discussions, there was a preference for providing that "only income acquired in the country should be affected" (i.e. subjected to tax by such country), although there was recognition that national regimes would differ and perhaps a rebate system would be appropriate (such as the foreign tax credit system ultimately adopted in the United States).[37] Notably, the proceedings included a copy of the 1921 Austro-Hungarian treaty, which explicitly provided for (i) taxation by the residence country and (ii) where there was a presence in another country, the right of each country to tax the portion of the income produced within its borders.[38]

As the ICC work evolved, the League of Nations was becoming organized. The ICC was in continuing contact with the League, "which is carrying on its work [in these matters], but which has not yet succeeded in collecting the reports which it has entrusted to all known economists".[39]

3.1.2. League of Nations[40]

The Fiscal Committee of the League of Nations commissioned four economists to study the double taxation problem.[41] These economic experts faced the same conundrum as had the ICC: the allocation of taxing jurisdiction between countries. The economic experts framed the issue more specifically than had the ICC First and Second Congress, and stated that the issue involved a conflict of interest between debtor (capital importing) countries and creditor (capital exporting) countries.[42] Members of the group argued in favour of residency-based taxation. In the end, there was a compromise such that the source country should have the right to impose "impersonal taxes" (i.e. withholding taxes) on the various classes of income, while the residence country should provide a foreign tax credit for such withholding taxes.[43] Several experts also championed a proposal that a foreign enterprise should not be considered to have a permanent establishment (PE) in a source country simply because it transacts business therein through an independent agent,[44] which position was adopted.[45] The impact of this recommendation was to exempt from source country taxation all profits derived by a foreign enterprise through independent agents, but, importantly, branches, affiliate companies and dependent agents were still considered PEs under the draft convention. Further, the Fiscal Committee made it clear that a source country would have no right to tax business profits from industrial and commercial activities on a net basis unless the foreign parent had a PE in the source country.

After making these critical clarifications, the Fiscal Committee issued its report on 15 April 1927. Accompanying it was a draft model income tax treaty (the 1927 Draft Model Convention) that used the classification-and-assignment approach set forth in the League 1923 Economic Experts Report and the League 1925 Technical Experts Report, but with a more narrow PE definition.[46]

In October 1928, the League of Nations' technical experts met again and issued a final report.[47] The 1928 Model Convention became the benchmark for treaty negotiations in

32. Id.
33. Id., at 16-17.
34. Id., at 9.
35. Id., at 11.
36. Id., at 12-13.
37. Id., at 46.
38. 1921 Austro-Hungarian Treaty, art. 4, 1923 ICC Proceedings, Brochure 25, at 50, which provided as follows:
    Income derived from the exercise of any kind of trade or industry is taxed by the State in whose territory the industrial or commercial undertaking has its registered office, even when the latter extends its activities into the territory of another contracting State. If the enterprise has its registered office in one of the contracting States, and in another has a branch, an agency, an establishment, a stable commercial organization, or a permanent representative, each one of the contracting States, shall tax that portion of the income produced in its own territory. Therefore the financial authorities of the interested states shall be able to request the tax-payer to hand in general balance-sheets, special balance sheets, and all other documents required by the laws of the said States.
39. The League's economic experts were appointed in Feb. 1921. 1925 ICC Proceedings, at 10.
40. The following discussion is drawn from B. Wells & C. Lowell, *Tax Base Erosion and Homeless Income: Collection at Source is the Linchpin*, 65 Tax. L. Rev. 535 (2012).
41. 1923 ICC Proceedings, Brochure 25, at 16.
42. League of Nations, Econ. & Fiscal Comm., *Report on Double Taxation Submitted to the Finance Comm.*, at 39-41, 48-49, League of Nations Doc. E.F.S.73.F.19 (1923).
43. *Report Presented by the Comm. of Technical Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.216M.85.II.A, at 11 (1927) (1927 Technical Expert Report).
44. League of Nations Comm. on Double Taxation and Fiscal Evasion, *Minutes of the Third Meeting held at London on 6 April 1927, at 3:30 p.m., League of Nations*, DT/8th Session, P.V.3.(1), at 9-10 (proposal made by M. Julliard representing the ICC and endorsed by Adams), available at T.S. Adams Collection, Yale University, Box 16, League of Nations 4-6 Apr. 1927 folder.
45. League of Nations Comm. on Double Taxn. & Tax Evasion, *Minutes of the Fourth Meeting held in London on 7 Apr. 1927, at 3:30 p.m., League of Nations*, DT/8th Session/P.V.4.(1), at 2 (proposed change to permanent establishment definition adopted), available in T.S. Adams Collection, Yale University, Box 16, League of Nations 7-8 Apr. 1927 folder.
46. 1927 Technical Experts Report, at 10-11.
47. *Report Presented by the General Meeting of Government Experts on Double Taxation and Tax Evasion*, League of Nations Doc. C.562M.178 1928 II (1928) (League of Nations Report (1928)).

Europe, and was instrumental in the development of the earliest US tax treaties.[48] Once this treaty framework was in place, the balance of power between source and residence countries was significantly changed through a continuing redefinition of the scope of activities that would fall within the purview of a PE and through continuing efforts to minimize the amount of source-based withholding taxes that would apply to cross-border payments.

3.2. Source country rejection

The historical record indicates that the ICC was the architect of a solution which sought to balance the interests of residence and source countries. This approach was ultimately superseded by the work of the League of Nations, which developed a solution that gave preference to residence as the predominant allocation criterion. It sought to provide a means of eliminating international double taxation and proceeded in a manner that enshrined the prevailing mercantilist paradigm into international tax law. The result was that potential double taxation was to be resolved by maximizing the allocation of residual profit of an MNE to the residence country vs. the source country (in the 1920s, this was viewed as imperial vs. colony countries; today, perhaps, as developed vs. developing or emerging countries).

Today, source countries increasingly reject the approach that arose from the treaty debates of the 1920s, which established a clear priority for the allocation of residual income to the residence country and treated interim holding companies, in essence, as a residence country. In the 90 years that have passed in the interim, the posture of residence and source countries has changed in dramatic ways, in many cases reversing – creditor countries of that era have, in some cases, become debtors of their former colonies.

The tension inherent in the evolution of the world from the 1920s to date suggests the need for a new global dialogue to update the foundational concepts of model income tax treaties.[49] In this connection, a thoughtful person might perhaps want to contemplate the consequences of a source country effort to develop model treaty and transfer pricing concepts, along the lines of the original ICC proposals. If such a source country model were to arise, there would be a noteworthy series of political and business issues to be addressed by all parties. MNEs would need to assess the impact of such new treaty concepts on their existing global ETR planning strategies. Governments would need to assess the impact of these concepts on their own budgetary models. Finally, organizations such as the OECD and UN would need to assess the impact of such developments on their roles in international taxation.

3.3. Implications of rejection

As source countries increasingly focus on the need to defend their tax bases, an MNE is likely to face the need to defend its ETR planning strategy against material assessments asserted on principles that may be inconsistent with the OECD Guidelines and the Commentary on the OECD Model Convention. These plans are often based on one-sided transfer pricing methodologies (e.g. transactional net margin method/comparable profit method, cost-plus method).[50] Such methodologies typically test the earnings of local country affiliates on the basis of the financial results in the country determined in accordance with the group's internal transfer pricing methodology. Accordingly, transfer pricing disputes often arise when the source country seeks a greater share of the global income of the MNE group than, in the MNE's view, should be attributable to the functions and risks performed in the country, given its transfer pricing methodology. The resulting controversies can drag on for long periods.

In the authors' experience in resolving these matters, it is often necessary to justify the one-sided methodologies by comparison to two-sided methodologies, which can address the desire of the source country to examine the functions and risks of all affiliates in view of the global financial results (not just those reported in its country). Such approaches are commonly used to resolve major transfer pricing cases at the competent authority or APA level between OECD member countries, as either primary or confirming methodologies.

In working with MNEs in anticipation of such defence needs, the authors find it instructive to prepare by using a two-sided analysis to confirm the one-sided analysis utilized for documentation purposes. This has a variety of benefits, including (i) confirming the ETR strategy, (ii) preparing for examination, (iii) realistically assessing exposures, (iv) responding to uncertain tax positions of financial auditors,[51] (v) preparing for an APA or other advance resolution processes, as appropriate, and (vi) providing internal comfort that the ETR can be defended, even in examination by aggressive source countries. Such analysis need not be included in contemporaneous documentation. Rather, it is prepared in anticipation of a future defensive need.

In the evolving world of source country transfer pricing and international taxation muscle-flexing, it is risky to assume that global tax planning approaches, as historically encouraged by the OECD/UN Model Conventions,

48. H.D. Rosenbloom & S.I. Langbein, *United States Tax Treaty Policy: An Overview*, at 359, 365, 19 Colum. J. Transntl. L. (1981). In short, the concept developed by the ICC in the period from 1920 through 1923 reflected a balance of *residence* and *source* criteria for the allocation of combined income of MNE affiliates pertinent to specific transactional flows. When the League of Nations became operational in 1923, the ICC approach changed in favour of a residence concept that became the base for the extant OECD/UN Models.
49. C.H. Lowell & B. Wells, *Tax Base Defense: Time to Update the Model Treaties?*, Intl. Tax J. 5 (Jan.-Feb. 2013).
50. By "one-sided", the authors mean transfer pricing methodologies that test the financial results of related-party transactions by focusing on one party to the transactions and the financial results of that party, as opposed to two-sided analyses that would focus on the parties to the transaction (two or more) and their combined income relating to such transactions. Lowell, Martin & Levey, *supra* n. 1, at para. 1.07.
51. C. Lowell & M. Martin, *US International Taxation: Practice and Procedure* para. 14.07(7) (Thomson Reuters 2016).

to achieve the lowest possible ETRs will necessarily be respected.

4. BEPS: A New Paradigm?

Prior to the past few years, it was rare that the global transfer pricing strategies of MNEs found their way onto the front pages of financial centre newspapers and magazines. This has been the case recently,[52] with the chorus of criticism growing in volume and intensity. Not surprisingly, governments shortly announced their intention to address these issues.[53] For example, the European Commission in 2012 unveiled plans to "crack down on tax havens and aggressive tax planning by companies" as a means of helping EU states recover from their economic downturns.[54] Similarly, the G20 asked the OECD to review applicable rules to reduce the ability of MNEs to shift profits (i.e. erode the tax base).[55]

As such commentary evolved, the tenor of public comment by the media, tax administrators, OECD officials, civil society and politicians tended to be a chorus pillorying MNEs and their tax planning arrangements as the bad guys in a base erosion drama.

As a result of these various elements, the G8 and G20 countries directed the OECD to study the tax-paying posture of MNEs.

4.1. Stated purpose

In February 2013, the OECD issued its report, "Addressing Base Erosion and Profit Shifting" (the Addressing BEPS report) and launched an ambitious project to study pertinent elements of the debate, including MNE strategies, transfer pricing, compliance and treaty mechanisms.[56] It framed the issues to be addressed as follows:

> While [MNEs] urge co-operation in the development of international standards to alleviate double taxation resulting from differences in domestic tax rules, they often exploit differences in domestic tax rules and international standards that provide opportunities to eliminate or significantly reduce taxation.[57]

The Report noted that base erosion constitutes a serious risk to tax revenues, tax sovereignty and tax fairness for OECD member and non-member countries alike. A significant source of base erosion is profit shifting. The apparent perception of the G20 and OECD seemed to be that tax administrations may not have kept pace with the changing business environment. Domestic rules and internationally agreed-upon standards were viewed as being grounded in an economic environment characterized by a lower degree of cross-border economic integration as reflected in MNE ETR planning strategies. This integration is composed of (i) the increasing importance of intangibles as a value-driver, and (ii) the constant development of information and communication technologies.

The Addressing BEPS report presented the issues to be addressed in an objective and comprehensive manner. It declared that improving tax compliance – onshore and offshore – remains a key priority for both securing governments' revenue and levelling the playing field for businesses. This would require determined action from tax administrations, which should cooperate in exchanging intelligence and information, as well as monitoring the effectiveness of the strategies so used. Critical elements of the Addressing BEPS report included the following:

Executive Summary. In order to address the range of issues needing attention:

> a holistic approach is necessary to properly address the issue of BEPS. Government actions should be comprehensive and deal with all the different aspects of the issue. These include, for example, the balance between source and residence taxation, the tax treatment of intra-group financial transactions, the implementation of anti-abuse provisions, including CFC legislation, as well as transfer pricing rules.[58]

Chapter 3 (Global business models, competitiveness, corporate governance and taxation). MNEs develop global value chains to conduct business across borders as efficiently as possible, developing global processes to maximize revenue and minimize expenses, including tax expense. At the same time, individual countries compete to attract economic growth, often at the expense of their neighbours in a "race to the bottom" (again, including tax expense). These policies are, needless to say, critical to MNEs, as tax is a material element of effective tax rates.

Chapter 4 (Key tax principles and opportunities for base erosion and profit shifting). The Addressing BEPS report also, appropriately, observed that the history of current international tax and treaty policy is charted from its origins in the post-World War I era conducted by the International Chamber of Commerce and the League of Nations.[59] The resultant transfer pricing and domestic tax principles were included in the laws of most countries, although it was noted that base protection frameworks

52. E.g. P. Campbell & M. Chorley, *Fury After Amazon Paid Less in Corporation Tax Than It Got in Government Grants Despite Making £4 Billion Through Sales*, Mail Online (15 May 2013); Drucker, *OECD Enables Companies to Avoid $100 Billion in Taxes*, bloomberg.net (18 Mar. 2013); Gapper, *Politicians Should Stop Posturing on Corporate Tax*, Financial Times (31 Jan. 2013); *UK's Top Companies Condemned for Prolific Use of Tax Havens*, The Guardian (15 May 2013); Thurm & Linebaugh, *More US Profits Parked Abroad, Saving Taxes*, Wall Street J. (10 Mar. 2013); *The Missing $20 Trillion*, The Economist (16 Feb. 2013), at 13; *Silicon Valley vs. Corporate Taxes*, Corporate Counsel (18 Mar. 2013); *Wake Up and Smell the Coffee*, The Economist (15 Dec. 2012), at 66; *Google Doubles Revenues Switched to Bermuda*, Fin. Times (13 Dec. 2012), at 18; *Pressure Mounts for Radical Rethink to End 'Tax Bonanza' for Companies*, Fin. Times (4-5 Jan. 2014).
53. *See* e.g. *OECD Committed to Holistic, Fundamental Review of Broken Tax System, Transfer Pricing Chief Says*, 21 BNA Tax Mgmt. Transfer Pricing Rep. 1023 (21 Feb. 2013).
54. *European Commission to Launch Plan Against Tax Havens, Corporate Tax Loopholes*, BNA Daily Tax Rep. (6 Dec. 2012), at I-2; *European Commission Calls for Larger Crackdown on Harmful Business Taxation*, BNA Daily Tax Rep. (7 Dec. 2012), at I-2. *See* sec. 6.2.
55. *G-20 Asks OECD to Review Rules With Goal of Curbing Profit Shifting*, BNA Daily Tax Rep. (11 Dec. 2012), at I-1.
56. OECD, *Addressing Base Erosion and Profit Shifting* (OECD 2013), International Organizations' Documentation IBFD. *See generally*, *As BEPS Report Released, Saint-Amans Says G-20 Push Could Speed OECD Work*, BNA Daily Tax Rep. (13 Feb. 2013), at I-2. A related focus was on what is often referred to as "double non-taxation" or homeless income. *See generally* M. Durst, *Fixing Double Nontaxation Under the Transfer Pricing Guidelines*, Tax Notes 785 (7 May 2012).
57. OECD, *Addressing Base Erosion and Profit Shifting*, *supra* n. 56, at 5-6.
58. Id., at 7.
59. As discussed in sec. 3.

could often be avoided through the use of, for example, branches, hybrid entities, hybrid financial instruments and leverage. The Addressing BEPS report declared that an effective corporate tax planning structure had four elements:

- minimizing corporate taxation in source countries;
- minimizing or eliminating withholding taxes in source countries;
- low tax in the recipient (residence) country, often the place where group intangibles are held; and
- no current taxation in the country of the parent.[60]

4.2. Failure to address residence vs. source

In short, the focus of the Addressing BEPS report was on the overall landscape. The report appropriately noted the evolution of treaty and transfer pricing policy from the post-World War I period. In framing the need for a holistic approach, the initial point, as noted above, was "the balance between source and residence". Unfortunately, this fundamental element was not addressed in the literally thousands of pages of BEPS materials that have been released, other than to note that "digital commerce is placing increasing pressure on these well-established principles".[61]

Rather, the focus of the Addressing BEPS report was on perceived misbehaviour by MNEs. There was no real commentary on the role that country-sponsored regimes have played in the ETR planning strategies adopted by MNEs over many generations, or on the premise from the League of Nations work that all countries would ultimately adopt similar tax systems for cross-border business.

4.3. Final Reports of the OECD BEPS project

The BEPS project evolved in an efficient manner, with initial reports issued on the 15 Actions in 2013 and 2014 and final reports issued in 2015.[62] The resultant guidance, comprising almost 1,800 pages, addresses each of the Actions.

4.4. Challenges of the BEPS project

While the BEPS principles may fairly be viewed as a grand design for an overall effective, consistent global tax system, achieving such results will require successfully addressing a variety of challenges, which are appropriate elements of both governmental evaluation of domestic policies as well MNEs' evolution of ETR planning strategies.

4.4.1. Limits of OECD authority

The OECD itself has no mandate to change law, even with the broad public endorsement of the G8 and G20. Accordingly, any actual change in treaty or transfer pricing policy will depend on action by sovereign states. Therein lies the fundamental threshold problem for an initiative such as this, namely that it relies on domestic implementation by individual countries.[63] In this regard, there is recent cooperation by governments across a broad spectrum of domestic systems and points-of-view in other areas of international tax compliance.[64]

The BEPS project anticipates that the issue can be effectively addressed via a multilateral instrument that would, in essence, amend all 3,000 or so treaties said to be in force based on the OECD and UN Models. While a multilateral instrument could, in theory, provide a path for broader implementation, there will remain issues, including whether countries will pick and choose issues upon which they agree to be bound; procedural issues to be addressed with respect to each country; and the relationship between treaty declaration, on the one hand, and domestic law and procedure on the other.

In other words, perfect alignment on international issues of such complexity and significance is unlikely due to national sovereignty and/or other factors. Principles are easier to agree upon in broad terms at an international policy level than they are to implement on the ground. Accordingly, in spite of the public enthusiasm for the Action Plan, the BEPS final reports are likely to be a step in the process, regardless of its outcome.[65]

As there will inevitably be variation in how states adopt the ultimate proposals from the OECD, it is doubtful that there will ever be a perfectly coordinated, supranational action on BEPS, even with a multilateral instrument. In practical terms, this means that the process envisioned by the Actions will be a starting point to address perceived shortcomings of current principles. At the time of the Addressing BEPS report, it was certainly hoped that consensus could be reached, as unilateral action by many countries would exacerbate existing controversy and eventual competent authority problems for both tax administrations and MNEs.[66]

60. OECD, *Addressing Base Erosion and Profit Shifting*, *supra* n. 56, at 73.
61. Id., at 35.
62. These materials are available at http://www.oecd.org/tax/beps-2015-final-reports.htm.
63. E.g. *BEPS Project Needs to Consider EU Law Prohibitions, Official Says*, 22 BNA Tax Mgmt. Transfer Pricing Rep. 305 (11 July 2013); Qassim, *Vodafone: Governments, Not Corporations, Shape Tax Policies*, 24 BNA Tax Mgmt. Transfer Pricing Rep. 1313 (3 Mar. 2016).
64. For example, there has been broad international cooperation with the US initiative addressing reporting of investment income, framed by the US Foreign Account Tax Compliance Act (FATCA); D.W. Gregory, *Collaboration on FATCA Sets Stage for Work on BEPS, Corwin Suggests*, BNA Daily Tax Rep. (1 Mar. 2013), at G-5. *See generally* Lowell & Martin, *supra* n. 51, at para. 7.05(1)(f).
65. D.W. Gregory, R. Mitchell & K.A. Bell, *OECD 'Action Plan' Raises Questions About Scope, Timing, and Feasibility of Reaching International Consensus on BEPS*, 22 BNA Tax Mgmt. Transfer Pricing Rep. 351 (25 July 2013); R. Mitchell, *Unilateral BEPS Actions Could Lead to Double Taxation, Business Tells OECD*, 22 BNA Tax Mgmt. Transfer Pricing Rep. 755 (17 Oct. 2013). *See* sec. 6.3.
66. *Saint-Amans Says BEPS Project Could Produce New Multilateral Treaty*, 21 BNA Tax Mgmt. Transfer Pricing Rep. 162 (13 June 2013). EU officials advised that the OECD will need to consider EU legal prohibitions, such as changing domestic laws, as the BEPS project evolves. *Base Erosion Project Needs to Consider EU Law Prohibitions, Official Says*, BNA Daily Tax Rep. (5 July 2013), at I-1.
The recommendations under the BEPS project may also be challenged under trade agreements, which could recognize critical factual or legal elements in a manner different than the OECD's BEPS project (such as ownership of tangible or intangible assets). In this regard, the list of potential trade agreements could include (1) the General Agreement on Trade and Tariffs (generally measures applicable to goods), (ii) the General Agreement on Technical Services and (3) bilateral investment agreements.

4.4.2. Prior OECD initiatives

A related practical reality is that the BEPS project is not the first time that the OECD has undertaken broad-based efforts to address perceived tax base erosion matters. In May 1996, OECD ministers called on the OECD to "develop measures to counter the distorting effects of harmful tax competition on investment and financing decisions and the consequences for national tax bases".[67] The heads of state of the then Group of Seven (G7) countries endorsed this request, urging the OECD "to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries would operate individually and collectively to limit the extent of these practices".[68]

While the project started off in a similar manner as BEPS, the net result after several years of the Harmful Tax Competition initiative was a broad-based expansion of information exchange agreements.[69]

The takeaway for the BEPS project is that it may or may not result in the type of coordinated, consistent action hoped for in the Addressing BEPS report.

4.4.3. Posture of BRICS and non-member source countries

A third practical element relates to the posture of the BRICS and other source countries. The BRICS, in particular, have been outspoken critics of the OECD Model and the OECD Guidelines for many years, preferring to chart their own direction.[70] In the BEPS project, there have been a variety of issues on which source countries plainly depart from the BEPS orthodoxy. Perhaps the most critical is dispute resolution, where the OECD supports mandatory binding arbitration, which is uniformly rejected by BRICS and source countries for a litany of reasons.[71] If this group opts out, developments from the BEPS project will have only a limited reach.

4.4.4. Coordination

As the BEPS project commenced, there were a variety of other similar processes, on a much smaller scale. For example, revision of the intangibles provisions of the OECD Guidelines involves many elements of the transfer pricing portion of BEPS Actions 8 through 10. In addition, there are many substantive elements of the BEPS final reports which will require domestic action, while others are yet to be addressed. The first item on the BEPS Action Plan concerns the digital economy, which the OECD attempted to address in the 2010 update of the OECD Model, although that update probably created more problems than solutions. It is projected that further guidelines on the digital economy will be published by 2020.[72] All of these elements will need to be developed and coordinated. A multilateral instrument is unlikely to achieve such results for all critical issues.

In addition to the substantive issues, many countries have made it clear that they will adopt the principles to further their own tax base objectives,[73] including the EU's embarking on its own agenda.[74]

Can these various elements be coordinated to produce harmony and consistency?

4.4.5. Transition

Finally, even if all of these elements can be harmonized, a further issue will be managing the transition from the status quo to any specific action ultimately undertaken by one or more countries. The likelihood that some states will want to move faster and more comprehensively than others is almost inevitable.[75] It seems that the OECD assumption is that all such issues will be handled by a multilateral instrument – a position that will remain to be seen.

As these processes evolve, there will be anxiety in both tax administrations and MNEs about any change in domestic or treaty law as to whether the evolution will be administrable, on the one hand, or able to be reasonably complied with, on the other.[76] There will also be anxiety about retroactive application of changes to rules[77] or the establishment of effective dates and grandfathering provisions.

4.4.6. Comment

Notwithstanding these practical issues, the BEPS project is a process that commenced with broad political support and could lead to an update of the OECD Model and OECD Guidelines in due course. However, it could, alternatively, end up like the Harmful Tax Competition initiative,[78] with little impact for either countries or MNEs. If there is not an outcome that addresses the demands of the BRICS and source countries, as well as all other parties having their own agendas,[79] it may be that an entirely different process will be undertaken.[80]

For example, if there is a splintering of positions by countries that take unilateral actions in the exercise of their sovereign authority,[81] it is likely that there will be an explosive increase in dispute resolution dockets, thereby aggravating the risk of double or multiple taxation for MNEs,

67. OECD, Ministerial Communiqué, 22 May 1996.
68. OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD 1998).
69. Lowell, Martin & Levey, *supra* n. 1, at para. 2.06(2).
70. *See* secs. 3.2. and 6.1.
71. Lowell, Martin & Levey, *supra* n. 1, at para. 12.05(6).
72. Lowell, Martin & Levey, *supra* n. 1, at para. 9.08(1)(d).
73. *See* sec. 6.3.
74. *See* sec. 6.2.
75. *See* sec. 6.3.
76. *BEPS Could Lead to 'International Chaos' If Not Managed Well, IRS Official Cautions*, 23 BNA Tax Mgmt. Transfer Pricing Rep. 3 (1 May 2014); *Treasury Pushing for 'Administrable' Documentation Rules under BEPS*, BNA Daily Tax Rep. (15 Jan. 2014), at I-1.
77. This anxiety is certainly well justified in view of the EU "State aid" process. *See* sec. 6.2.
78. *See* sec. 4.3.b.
79. A. Bennett, *BEPS Proposals Face Hurdles in [US] Congress as Other Countries Act, NFTC Official Says*, 23 BNA Tax Mgmt. Transfer Pricing Rep. 1204 (22 Jan. 2015).
80. For an excellent explanation of the "bubble" surrounding these issues from a variety of perspectives, *see* M. Herzfeld, *Bursting Global Tax Bubbles*, 82 Tax Notes Intl. 315 (25 Apr. 2016).
81. *See* sec. 6.3.

bottlenecks for tax administration and increased costs for all parties.[82]

5. BEPS First Step: Country-by-Country Reports

5.1. General

The final report on Action 13 was issued in September 2015.[83] It contains an update (actually, a replacement) of the provisions of the OECD Guidelines dealing with documentation (Chapter V), as well as annexes providing guidance for the preparation of country-by-country documentation. The intention is to provide guidance for tax administrations in developing rules and/or procedures for MNE transfer pricing documentation relating to the arm's length standard.[84] The intention is that clear and widely adopted documentation rules can reduce compliance costs.[85]

Specifically, the principal objectives of the country-by-country reporting guidelines, as stated in the Action 13 Final Report, are as follows:[86]

- ensure that MNEs give appropriate consideration to transfer pricing requirements in establishing prices and other conditions for transactions between their controlled entities and reporting the income derived from such transactions in respective tax returns;
- provide tax administrations with the information necessary to conduct an informed transfer pricing risk assessment; and
- provide tax administrations with useful information to employ in conducting an appropriately thorough audit of transfer pricing practices of entities subject to tax in their jurisdiction, although it may be necessary to supplement the documentation with additional information as the audit progresses.

The OECD Guidelines contemplate that countries should adopt a standardized approach to transfer pricing documentation, consisting of (i) a master file containing standardized information relevant for all MNE group members, (ii) a local file referring specifically to material transactions of the local taxpayer, and (iii) a country-by-country report containing certain information relating to the global allocation of the MNE's income and taxes paid, together with certain indicators of the location of economic activity within the MNE group.[87] While the country-by-country report format requires a breadth of information that is far beyond what has traditionally been included in transfer pricing documentation in most countries (the local and master files are similar to such documentation), the data are largely consistent with the type of information required to facilitate resolution of material bilateral competent authority or advance pricing agreement cases.

These reports will provide tax administrations with relevant and reliable information to perform an appropriate risk assessment. They will also provide MNEs with "a means and an incentive to meaningfully consider and describe their compliance with the arm's length principle in material transactions".[88]

As with other BEPS Actions, the country-by-country reporting process will need to be approved in appropriate manners on an individual country basis[89] unless a multilateral agreement can be developed on a broad basis (which is well underway). All such processes are subject to a variety of limitations and hurdles.[90]

5.2. Implication of country-by-country reports

The country-by-country reporting elements of the OECD Guidelines reflect a broad consensus of countries with respect to the information that is needed to conduct appropriate transfer pricing examinations of MNE groups where there are material cross-border flows and the potential for concern about the overall transfer pricing strategy of the group. The country-by-country reporting data will facilitate risk assessment, and tax base protection as it provides a global data template for tax authorities to see the overall picture and proceed with examinations and adjustments accordingly.[91]

Accordingly, it will be appropriate for many MNEs to immediately consider integrating the country-by-country reporting elements into their standard transfer pricing documentation processes. The master and local reports may not pose serious hurdles for many groups. On the

82. D.W. Gregory, *BEPS Effort Will Ramp Up Pressure on Competent Authorities, Danilack Says*, 22 BNA Tax Mgmt. Transfer Pricing Rep. 901 (28 Nov. 2013); K.A. Bell, *US Official: Unilateral Measures Violate Spirit of BEPS*, BNA Daily Tax Rep., at G-2 (16 May 2016).
83. OECD, *Transfer Pricing Documentation and Country-by-Country Reporting – Action 13: 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 5 Oct. 2015), International Organizations' Documentation IBFD.
84. OECD, *Action 13 Final Report*, at para. 1.
85. OECD, *Action 13 Final Report*, at para. 4.
86. OECD, *Action 13 Final Report*, at para.5.
87. OECD, *Action 13 Final Report*, at para. 16. There should also be a listing of all group members, including the jurisdiction of incorporation (where different from the jurisdiction of residence), and the nature of the main business activities carried out by the member. OECD, *Action 13 Final Report*, at para. 24. Information to be included in the country-by-country report is set out in Annex III to the Guidelines. It is suggested that the country-by-country report include all countries in which the MNE group has "an entity resident for tax purposes, regardless of the size of business operations in that tax jurisdiction". OECD, *Action 13 Final Report*, at para. 34. In Mar. 2016, the OECD issued a new electronic format, the "CbC XML Schema", for exchanging country-by-country reports.
88. OECD, *Action 13 Final Report*, at para. 17. For a detailed explanation of the respective requirements by line-item, *see* S. Rasch, K. Mank & S. Tomson, *BEPS Action 13: An In-Depth Look at the Final Country-by-Country Reporting Requirements*, 24 BNA Tax Mgmt. Transfer Pricing Rep. 911 (12 Nov. 2015).
89. OECD, *Action 13 Final Report*, at paras. 48-50.
90. For example, the Action 13 Final Report addresses a variety of largely administrative matters that will depend on local or treaty law evolution. These include (i) the relationship to contemporaneous documentation requirements, paras. 22-28, (ii) time frames, paras. 29-31, (iii) application of materiality thresholds, paras. 32-34, (iv) document retention, paras. 35-36, (v) frequency of documentation updates, paras. 37-38, (vi) language, para. 39, (vii) application of local penalty provisions, paras. 40-43, (viii) confidentiality, paras. 44-45 and (ix) other issues, such as geography of comparables, paras. 46-47.
91. Such processes have also been a fact of life for at least 25 years in a variety of countries. The nature of the examinations and the means of resolving any disputes have evolved over this period. For example, the Japan-United States relationship has evolved from a contentious process with similar data demands and significant proposed adjustments, to a smooth and harmonious competent authority relationship (as exists in other contexts, as well).

other hand, the country-by-country report may pose serious obstacles for those groups having not undertaken system or profit split analyses for purposes of prior audits, APA, or competent authority purposes (due to, for example, systems limitations, accounting differences, false assumptions and country-specific issues). The authors' experience is that there are inevitably surprises when a robust system profit analysis is undertaken.

The likely outcome of the country-by-country reporting process as it matures and is implemented can be expected to include the following:

- country-by-country reporting data will provide a transparent view of MNE activities;
- it can rationally be assumed that the data will become public at some time;
- there will be more common focus by tax authorities on profit split methodologies;
- this will lead, with the other BEPS Actions, to an ever-increasing volume of proposed adjustments at the examination level; and
- the already expanding docket of competent authority cases will continue to expand in developed as well as developing countries, reflecting the need to develop dispute resolution processes that can be accepted by most countries (as opposed to the OECD demand for binding mandatory arbitration).

6. BEPS: Goals Achieved?

The essential goal of the BEPS project was to facilitate cooperation among countries in the development of international standards to alleviate double taxation resulting from differences in domestic tax rules. Achievement of that goal would require broad and consistent implementation of the BEPS Actions. Has this been, or will it be, achieved? There are a variety of elements that can be consulted for guidance.

6.1. Source country rejection of substantive BEPS and OECD work

As noted, source countries have broadly declared their rejection of traditional treaty and transfer pricing principles.[92] In the BEPS contexts, BRICS members of the G8 and G20 have endorsed the BEPS project,[93] and are implementing country-by-country reporting. Whether high-level political endorsement of a plan of action will translate into implementation of technical proposals on a consistent basis will be an interesting process to observe.

The initial BEPS report advised that its efforts were "not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income",[94] meaning that the longstanding objections of developing countries to the source vs. residence foundation of treaty and transfer pricing principles were not addressed. In addition, the BEPS project did not explicitly address the need of developing countries to institutionalize effective tax administration practices (including dispute resolution, as many developing countries have no experience with competent authority or related proceedings), although efforts are certainly being made in that direction.[95]

In any event, the apparent trend in the BRICS and source countries seems to be at odds with the overall direction of the BEPS project. The issues that are likely to be most critical to these countries could be along the following lines:

- preference for two-sided (profit split) over one-sided transfer pricing testing to assure that source country functional activities are appropriately taken into account in allocating residual income;
- expansion of the definition of "intangible" assets so as to include a broad range of local market synergies (the so-called "China premium");
- undue restriction of source country abilities to tax all income from pertinent economic activity due to permanent establishment limitations in the current Models;
- UN adoption of withholding on technical service payments;[96]
- the necessity for exit taxes and general anti-avoidance principles in backstopping transfer pricing and domestic tax enforcement;
- extra-territorial reach (the *Vodafone* issue in India);[97]

92. *See* sec. 3.2.
93. *Former Chinese Official Says BRICS Influencing OECD's Base Erosion Project*, 21 BNA Tax Mgmt. Transfer Pricing Rep. 1138 (4 Apr. 2013) (former Chinese SAT official indicating different interests of developed and developing countries with respect to tax base protection, including scepticism as to whether the OECD can accommodate the needs of source countries). K.A. Bell, *Saint-Amans: China, India Participating in BEPS Project on Par With OECD Members*, 22 BNA Tax Mgmt. Transfer Pricing Rep. 690 (19 Sept. 2013); K.A. Bell, *India Supports Significant People Functions Approach of BEPS Plan, Practitioners Say*, 22 BNA Tax Mgmt. Transfer Pricing Rep. 362 (25 July 2013); *Asia-Pacific Nations Announce Joint Task Force to Tackle BEPS*, BNA Daily Tax Rep. (2 Dec. 2014), at I-1.
94. L.A. Sheppard, *BEPS and EU Progress Report*, 151 Tax Noted 1743 (27 June 2016) (quoting the OECD Director as admitting that a discussion of source v. residence would have to take place if developing countries are to be brought on board the BEPS process).
95. R. Mitchell, *Businesses Need Role in Helping Developing Countries Fight BEPS, Shell Tax Chief Says*, 23 BNA Tax Mgmt. Transfer Pricing Rep. 111 (15 May 2014); Parker, *OECD to Create Regional Tax Networks as Part of BEPS Plan for Developing Nations*, 23 BNA Tax Mgmt. Transfer Pricing Rep. 914 (13 Nov. 2014); D.D. Stewart, *Sol Picciotto: BEPS and the Developing World*, 76 Tax Notes Intl. 1060 (22 Dec. 2014); Stewart, *OECD Plans Greater BEPS Project Role for Developing Countries*, 2014 Worldwide Tax Daily 219-7 (13 Nov. 2014).
96. There is a proposal to revise the UN Model so as to facilitate the taxation of technical services provided from inside or outside a source country. *See Draft Article and Commentary to UN Model Tax Convention on Payments for Technical Services (September 30, 2014)*, reprinted in 23 BNA Tax Mgmt. Transfer Pricing Rep. 1016 (27 Nov. 2014); *Tax Committee Revising Commentary to Article 9 of UN Model Convention*, 22 BNA Tax Mgmt. Transfer Pricing Rep. 866 (14 Nov. 2013). Three variations have been considered, namely (i) Alternative A: allows source country to tax all payments by resident companies, (ii) Alternative B: allows only taxation of services performed in the source country; and (iii) Alternative C: limits the source country to taxing services performed for more than a specified minimum number of days.
This discussion also includes digital or cloud computing taxable presence matters. There is active debate between those countries favouring a broad *source* country right to tax and other countries apparently taking a more status quo-oriented approach (only if traditional PE criteria are satisfied, including physical presence).
97. IN: HC Mumbai, 8 Sept. 2010, *Vodafone International Holdings B.V. v. Union of India*, Writ Petition 1325 of 2010, Tax Treaty Case Law IBFD; *India Vodafone Ruling Holds Foreign Firms Liable for Capital Gains*, BNA Daily Tax Rep., at I-1 (9 Sept. 2010). The Supreme Court has agreed to

– rejecting the insistence of BEPS Action 14 on binding mandatory arbitration for dispute resolution.

At this point, it seems appropriate to perceive that source countries as a group reflect a posture that is distinct from the overall framework of the BEPS project. Accordingly, the long-term success of the BEPS project may depend materially on whether source or developing countries evolve into a consistent posture.[98]

6.2. EU goes its own way

The EU has been undergoing its own evolution with respect to its Code of Conduct process and overall tax harmonization. In essence, many traditional regimes designed to attract foreign investment to a specific country are being dismantled. This focus began well before commencement of the BEPS project. Even at the time, it was often remarked that the eventual impact of such actions may be to drive MNEs from the EU.[99]

As the BEPS project commenced in 2012, EU activities relating to internal review of the ruling and related regimes of EU Member States accelerated. The principal focus was on whether some Member States had provided illegal tax subsidies to induce certain MNEs to locate activities in their countries which were not available to other similarly situated MNEs.[100] Under applicable EU law, if it were to be determined that an MNE had received "State aid",[101] the country in question would be obligated to retroactively recover such aid from the MNE (which could be for a period as long as ten years).[102]

Such a result could be a financial disaster for an MNE. Not only would it have to repay the "aid", with compounded interest for up to ten years prior to the opening of an investigation (i.e. expiration of pertinent statutes of limitation for income tax purposes may not prevent recovery of such unlawful State aid), but it may not be able to obtain a deduction, treaty relief (via competent authority or otherwise) or a foreign tax credit for the payment. In addition, the MNE may face tax liabilities in other countries which pursue transfer pricing or other examinations to protect their own tax bases from the State aid provided to the MNE.

Specifically, the European Commission undertook several in-depth investigations concerning certain specific rulings, which were perceived to facilitate lower taxable income via intra-group allocations inconsistent with applicable transfer pricing criteria, obtained by named MNEs in Ireland,[103] the Netherlands[104] and Luxembourg.[105] The Commission also raised questions about other countries (such as the UK patent-box regime[106] and Belgian "excess profits" deductions[107]), sending enquiries to Member States.

The European Commission released significant decisions in the summer of 2016, some involving determinations actually reached at an earlier point in time.[108] The nature of the decisions is illustrated by a decision in *Apple, Inc.* (ACo) that was released on 30 August 2016.[109] A US public company had two Irish subsidiaries which, respectively, handled manufacturing and sales. The Irish subsidiaries participated in a cost sharing agreement with the US parent, pursuant to which each obtained rights to manufacture and sell parent company products outside the Americas. The subsidiaries received rulings from the

hear the taxpayer's appeal. *See also* N. Mehta, *India: Beyond Vodafone to the Direct Taxes Code*, 2011 Worldwide Tax Daily 20-15 (31 Jan. 2011).

98. R. Mitchell, *OECD Developing 'Inclusive' Framework for Implementing BEPS*, 24 BNA Tax Mgmt. Transfer Pricing Rep. 956 (26 Nov. 2015); *BEPS: A Developing Country Perspective*, Intl. Tax Rev. 12 (Oct. 2015).
99. *EU Tax Rules May Backfire: Uniformity Was to Level the Field but Could Do the Opposite*, Wall Street J. (9 Oct. 2003), at A16.
100. T. Fairless, *US Firms Probed on Taxes*, Wall Street J (12 June 2014), at B1; *A Bit Too Cosy?*, The Economist (4 Oct. 2014), at 71; S.S. Johnston & Parillo, *EU to Investigate Amazon Tax Ruling for State Aid Breach*, 2014 Worldwide Tax Daily 195-1 (8 Oct. 2014) (focusing on certain benefits allegedly provided by Luxembourg); *European Commission Commissioner Says Apple Tax Probe is Priority*, BNA Daily Tax Rep. (3 Oct. 2014), at I-2 (focusing on Ireland and Luxembourg).
101. Treaty on the Functioning of the European Union of 13 December 2007, OJ C115 (2008), art. 107, EU Law IBFD (TFEU). There are five cumulative conditions, namely (i) economic advantage, (ii) selectivity, (iii) granted by State, (iv) distortion of competition and (v) effect on trade between member states. Only the EU can approve State aid measures. Tax rulings can constitute State aid.
102. The procedures to be followed in such investigations involve several steps, namely (i) initiation, (ii) preliminary investigation, (iii) in-depth investigation, (iv) final decision, (v) appeal to the EU Court of Justice by a party and (vi) role of the beneficiary (MNE). R. Mitchell, *EU State Aid Rulings Might Seek Recovery of Taxes Going Back 10 Years*, 23 BNA Tax Mgmt. Transfer Pricing Rep. 1615 (30 Apr. 2015); W. Hoke, *Adverse EU State Aid Ruling Could Have Material Impact on Apple*, Worldwide Tax Daily 84-1 (1 May 2015). For a discussion of the longest State aid dispute, *see* J. Kirwin, *EU Says French Utility Must Repay $1.5B in Tax Breaks*, 24 BNA Tax Mgmt. Transfer Pricing Rep. 313 (23 July 2015).
103. For a discussion of the evolution of one such investigation, *see* Satariano, *Apple May Face $8 Billion Tax Bill After Europe Probe*, BNA Daily Tax Rep., at I-1 (19 Jan. 2016).
104. *European Commission Rules Against Dutch Transfer Pricing Deal for Starbucks*, BNA Daily Tax Rep. (17 Nov. 2014), at I-2; Solanki, *Netherlands Has 'Strong Case' in EU Starbucks Tax Appeal*, 24 BNA Tax Mgmt. Transfer Pricing Rep. 1011 (10 Dec. 2015).
105. European Commission, *State Aid SA.38944 (2014/C)—Luxembourg: Alleged Aid to Amazon by Way of a Tax Ruling* (10 July 2014), available at http://ec.europa.eu/competition/state_aid/cases/254685/254685_1614265_70_2.pdf. *See also* T. Fairless, *EY Presses Amazon on Taxes*, Wall Street J (17-18 Jan. 2015), at B3. There was also a material disclosure (i.e. leak) of certain information that fuelled the inquiries. *See* S. Bodoni, *Gramengna Calls LuxLeaks "Game Changer" for Tax-Deal Probe*, BNA Daily Tax Rep. (23 Dec. 2014), at I-1; M. Karnitschnig, *Luxembourg Tax Leak Puts EU's Juncker under Further Pressure*, Wall Street J. (7 Nov. 2014), at B1 (documents show extent of corporate tax deals brokered in Luxembourg during term of current EU Commission President).
106. J. Kirwin, *EU Ends Parent-Subsidiary Provision; Begins Probe of 'Patent Box' Tax Schemes*, 23 BNA Tax Mgmt. Transfer Pricing Rep. 343 (26 June 2014); S.S. Johnston, *EU Clarifies Position on Patent Box Inquiry*, 2015 Worldwide Tax Daily 25-2 (6 Feb. 2015); L.A. Sheppard, *Are EU Patent Boxes State Aid?*, 77 Tax Notes Intl. 383 (2 Feb. 2015). In autumn 2014, the European Union, Germany and the United Kingdom reached an agreement on the treatment of patent boxes, requiring that the benefit be available only for R&D actually performed in the country (with existing arrangements grandfathered until 2021). *European Union, Germany, UK Reach Agreement on Proposed Limits of Patent Boxes*, BNA Daily Tax Rep. (12 Nov. 2014), at I-5. Subsequently, the EU dropped the inquiry. *EU Drops 'Patent Box' Tax Probe Involving Drug, Tech Companies*, BNA Daily Tax Rep., 3 Feb. 2015, at I-2. *See also Patently Problematic*, The Economist (29 Aug. 2015), at 53-54 (describing the "beggar-thy-neighbour" policies being followed by certain G20 countries).
107. *Belgian 'Excess Profit' Tax Deductions for Multinationals Face EU Probe*, BNA Daily Tax Rep. (5 Feb. 2015), at I-1.
108. A. Gupta, *Wake Up and Smell the Coffee: State Aid Power Grab*, 83 Tax Notes Intl. 17 (4 July 2016); Parker, *Netherlands, Starbucks Agreement Flawed: European Commission*, 25 Tax Mgmt. Transfer Pricing Rep. 281 (30 June 2016); Herzfeld, "State Aid Bureaucrats Run Amok", 82 Tax Notes Intl. 1127 (20 June 2016).
109. *See* European Commission press release, *State Aid: Ireland Gave Illegal Tax Benefits to Apple Worth up to € 13 Billion* (30 Aug. 2016), available at http://europa.eu/rapid/press-release_IP-16-2923_en.htm.

Irish government in 1991 and 2007 approving a split of profits between the branches of the sales sub. The Irish branch received a one-sided transfer pricing return (under a TNMM methodology), with the balance being allocated to the "main office" which was asserted to be located in no country and having no employees or physical assets (all decisions were made by directors, many of whom were employees of the parent). The result of the ruling was that only a small portion of the profits were taxed in Ireland. The remainder were not taxed (with ultimate US tax deferred until actual distribution under applicable US tax principles). The net result was an effective tax rate of 0.05% in early years, but declining to 0.005% in subsequent years as the overall sales increased.

The Commission concluded that the Irish ruling arrangement violated State aid principles. It noted that the purpose of those principles was to allow the Commission to assure that all taxpayers are afforded equal treatment, including allocation of profits within a group in a manner that reflects economic reality – i.e. in accordance with the arm's length principle. The rulings in question were found to endorse "an artificial allocation of profits... which has no factual or economic justification".[110] Accordingly, the Commission concluded that the profits of the head office should have been recorded in the Irish branch and subjected to Irish tax. Accordingly, the Commission ordered Ireland to recover tax on the profits in question (approximately EUR 14 billion plus interest).

There have also been a variety of other State aid developments.[111]

The response to these decisions has been interesting, to say the least. Defenders indicate that the decisions are consistent with the overall direction of EU law, seeking to develop a consistent EU-wide jurisprudence.[112] It has also been noted that the *Apple, Inc.* decision reflects:
- an absence of appropriate Irish government application of transfer pricing principles;[113]
- flaws in the US cost sharing regulations (which may have approved the overall methodology and results from a home country perspective);
- US tax principles encourage the earning of income in low-tax jurisdictions without repatriation to the US parent; and
- US-based MNEs need to reconsider their global tax policies, which may have resulted in pockets of low-taxed earnings that are attractive to local country tax authorities.[114]

Home countries of the MNEs subjected to these Commission declarations have largely denounced the decisions on a variety of grounds, including an unprincipled attack on MNEs,[115] retroactive declaration of applicable principles and inconsistency with the arm's length principle.[116] Commentators have strongly criticized the Commission decisions by, in essence, declaring that the Commission is the arbiter of transfer pricing issues within the EU, ignoring OECD and other global guidelines, as well as the domestic interpretations of the tax authorities of the country granting the rulings or APAs.[117]

In addition to State aid, the EU has also undertaken a variety of other initiatives, including revival of its proposal for a consolidated common corporate tax base with a likely formulary apportionment methodology (CCCTB). Prior to the start of the BEPS project, it was suggested that the final adoption of the CCCTB could be problematic as a political matter. Many Member States complained that such a common corporate tax base violates the "subsidiary" provisions of the EU Constitution.[118] The proposal was also criticized by MNEs as only increasing compliance obligations.[119] Nonetheless, it was suggested that the CCCTB could be fully implemented by 2012.[120]

In the post-BEPS period, with the EU focus on the State aid investigations, there was renewed interest in the CCCTB.[121] Analysis has focused on whether implementation would reflect adoption of some of the critical BEPS measures.[122] Interestingly enough, a variety of major MNEs have sup-

110. *See supra* n. 99.
111. I. Wishart & A. White, *Belgian Minister: EU Demand for Tax Repayments 'Stupid'*, 25 Tax Mgmt. Transfer Pricing Rep. 30 (12 May 2016) (describing EC demand that Belgium recover back tax payments from some 35 MNEs).
112. K.A. Bell, *EU Official: Most Appropriate Method Overlooked in Rulings*, 25 Tax Mgmt. Transfer Pricing Rep. 4 (12 May 2016) (comments of an EC official responsible for the State aid process); M. Herzfeld, *Is the EU a Country? Creditability of State Aid*, 83 Tax Notes Intl. 1004 (19 Sept. 2016).
113. K.A. Bell & Mitchell, *Apple's Lack of Pricing Analysis a Linchpin in EU, Ireland Case*, Daily Tax Rep., at L-1 (30 Aug. 2016).
114. A.S. Elliot & L.A. Sheppard, *BEPS Failure and Multilateral Initiatives*, 2016 Worldwide Tax Daily 179-1 (15 Sept. 2016).
115. M. Bologna, *Treasury Official Slams EU's Tax Demands on Apple*, Daily Tax Rep., at G-1 (14 Sept. 2016); A. Gupta, *Apple State Aid Case: A Spurned Olive Branch*, 83 Tax Notes Intl. 1001 (19 Sept. 2016).
116. US: Treasury, White Paper, *The European Commission's Recent State Aid Investigations of Transfer Pricing Rulings* (24 Aug. 2016). *See also* J.M. Kadet, *Thoughts on Treasury's White Paper on EU State Aid*, 83 Tax Notes Intl. 10, at 877 (5 Sept. 2016); A.M. Parker, *EU-US Tensions Simmer over Apple, State-Aid Tax Cases*, Daily Tax Rep., at G-8 (20 Sept. 2016). Another area or critical focus has been the correlative consequences of the Commission's decisions. If the decisions are upheld in whole or in part, one ultimate issue will be the extent to which the MNEs will be entitled to relief in the country which granted the rulings and, ultimately, whether any such recoupment from the MNE would be eligible for foreign tax credit relief in the home country. *See generally* L. Browning, *Apple's Ireland Bill Puts US Treasury in Tax Credit Bind*, 25 Tax Mgmt. Transfer Pricing Rep. 538 (15 Sept. 2016); Herzfeld, *supra* n. 112; A. Lewis, *BEPS, State Aid Issue Raise Questions About Foreign Tax Credits*, Tax Notes 38-4 (26 Feb. 2016).
117. M. Herzfeld, *State Aid Bureaucrats Run Amok*, 82 Tax Notes Intl. 1127 (20 June 2016).
118. *EU Member States Likely to Adopt Common Corporate Tax Base, May Omit 'Consolidated'*, 20 BNA Tax Mgmt. Transfer Pricing Rep. 369 (8 Sept. 2011); *France, Germany Plan Joint Corporate Tax by 2013; Leaders Urge Cooperation for Euro*, BNA Daily Tax Rep. (17 Aug. 2011), at I-2; *9 EU Countries Express Subsidiary Concerns Over CCCTB Proposal*, Worldwide Tax Daily 102-1 (26 May 2011); *Irish, UK Parliaments Reject CCCTB Proposal*, 2011 Worldwide Tax Daily 100-1 (24 May 2011); European Commission, Dir.-Gen. Taxn. & Customs Union, *Anti-Abuse Rules in the CCCTB*, Workshop on the Common Consolidated Corporate Tax Base (CCCTB) (20 Oct. 2010), available at https://ec.europa.eu/taxation_customs/sites/taxation/files/docs/body/2010-10-20-wp-antiabus_en.pdf.
119. *AstraZeneca Tax Official Says Company Would Not Opt for EU's Proposed CCCTB*, 19 BNA Tax Mgmt. Transfer Pricing Rep. 1255 (7 Apr. 2011).
120. *Semeta Hoping Council Will Approve CCTB by End of 2012; Practitioners Assess Likelihood, Consequences of Full Adoption*, 19 BNA Tax Mgmt. Transfer Pricing Rep. 1337 (21 Apr. 2011).
121. J. Kirwin, *European Commission to Revise CCCTB Proposal with Optional Tax Rates*, BNA Daily Tax Rep. (14 Nov. 2014), at I-2.
122. R. Finley, *Proposed Directive on CCCTB Adopts BEPS Measures*, 2015 Worldwide Tax Daily 242-2 (17 Dec. 2015) (including BEPS measures for PE definition, interest limitations and CFCs).

ported adoption of the CCCTB based on a desire for simplification, although it may also reflect a conclusion that the CCCTB could be preferable to the full range of BEPS provisions relating to their EU operations.[123]

Like the position of source countries, the independent attitude of the EU reflects one more source of disharmony among countries.

6.3. Country-specific regimes emerge

As the BEPS project was winding up, many countries determined that domestic tax base needs required additional safeguards or incentives to attract business from other countries. A notable illustration is provided by the evolving situation in the United Kingdom.

On the one hand, the United Kingdom has taken significant strides to attract economic activity. This has been accomplished via a combination of low tax rates (to be reduced to 17% by 2020), rapid amortization, a territorial tax regime and an attractive patent box. These incentives are augmented by an extensive treaty network, experienced competent authority expertise, and a cooperative attitude from the tax authorities. Needless to say, these are the elements that make the United Kingdom an attractive potential location for investment, which, if successful, will result in such investment not being made in other countries.

On the other hand, it has also undertaken to protect its tax base via penalizing certain transfers via a diverted profits tax.[124] It is intended to deter the diversion of profits from the United Kingdom by large groups that (i) seek to avoid creating a UK PE, or (ii) use arrangements or entities lacking economic substance to exploit tax mismatches through intra-group expenditure or diversion of income in circumstances where it is reasonable to assume that – absent a tax benefit – the expenditure would not have been incurred or the income would have been within charge to UK corporation tax. Diverted profits tax applies to diverted profits arising on or after 1 April 2015. The normal rate is 25% of the diverted profit plus any "true-up interest". The legislation provides a strong incentive for MNE groups to provide timely information about high-risk transfer pricing transactions. It is intended to promote full disclosure and early engagement with the tax authorities (HMRC).

UK officials proclaim that the diverted profits tax is "consistent with the objective of the BEPS project". It was introduced "to protect ourselves against highly contrived arrangements to avoid UK tax. Its objective is to ensure profits are taxed in the UK when the economic activities that give rise to them take place here". These are arrangements where an MNE "goes to extraordinary lengths to avoid paying tax in the UK".[125] Interestingly, the diverted profits tax is similar in effect to the UN evolution of withholding on technical service payments.[126]

Whether the diverted profits tax is consistent with the BEPS project or reflects a lack of confidence in the BEPS project will all remain to be seen.[127]

Other countries are similarly undertaking their own developments.

6.4. BEPS: A reflection of the chaos in the world

While the goal of the BEPS project was to facilitate cooperation among countries to prevent base erosion, there is, to date, no indication that countries will consistently adopt the overall design, as opposed to utilizing those elements that are consistent with their respective self-interests. The postures of source countries and the EU, as well as unilateral actions by countries (including leaders in the BEPS project like the United Kingdom), do not reflect harmony among countries. Rather, they seem to reflect a predictable need of countries to protect and enhance their own tax base. Each country has its own idiosyncratic elements, whether cultural, economic, political, or otherwise. Whether a multilateral instrument or other evolution will alter this apparent trend is an issue that will have no clear answer for many years.

In this regard, it is worthwhile to consider whether the BEPS project reflects a current day rendition of the League of Nations efforts in the 1920s. As noted, its premise was that residual income should be allocated to the residence country of an MNE (or the location of an interim holding company), implicitly because the parent company could be deemed to have provided the most valuable elements of generating the economic activity. The source country, on the other hand, was deemed to provide – in today's terms – support functions. It also seemed to have been assumed that countries would in due course embrace consistent tax principles.

As time passed, countries developed idiosyncratic tax regimes to achieve their own objectives, including generation of the maximum economic activity from their respective resource bases. In developing ETR planning strategies, MNEs over many generations did the same, in the sense of conducting business in a manner to generate economic productivity with the least tax expense, taking advantage of incentives offered by individual countries (which competed to attract such activity).

Nearly a century later, countries have determined that planning models of MNEs were abusive, and thus the

123. Kirwin, *Google, Facebook, Others Back CCCTB in Pending EU Legislation*, 24 BNA Tax Mgmt. Transfer Pricing Rep. (26 Nov. 2015).
124. "Diverted Profits Tax Guidance" (HMRC 2015) (which contains detailed explanations of respective elements). Following consultation, HMRC made a variety of changes to the initial diverted profits tax legislation (revising HMRC notification requirements and expanding the "avoided PE" rule), which are explained in "Summary of Amendments Following the Technical Consultation" (HMRC 2015). *See also* K.A. Parillo, UK Diverted Profits Tax Legislation Both Narrowed and Broadened, 2015 Worldwide Tax Daily 57-2 (25 Mar. 2015).
125. *UK Financial Secretary Addresses Business Taxation Plans*, 2015 Worldwide Tax Daily 105-21 (2 June 2015) (remarks of Financial Secretary David Gauke).
126. *See* sec. 6.1.
127. S. Picciotto, *The UK's Diverted Profits Tax: Admission of Defeat or Pre-Emptive Strike?*, Worldwide Tax Daily 12-12 (20 Jan. 2015); *US Official Says UK's Diverted Profits Tax Undercuts BEPS Work*, BNA Daily Tax Rep. (11 May 2015), at G-12.

BEPS project was initiated. The underlying premise has been that countries are the victims of MNE planning. Scant attention is given to the reality that countries develop their own regimes and MNEs conduct business in a manner so as to take advantage of incentives offered by countries consistent with efficient business operations.

As these processes evolve, MNE strategic plans will need to adapt to the new realities. These will include the specific regimes developed by countries to maximize economic activity within their borders, as is occurring in the United Kingdom. While the intentions of the BEPS project were laudable, the reality may be that, as countries adopt unilateral measures, MNEs will find an epochal opportunity to adapt their ETR planning strategies. Why could this be the case? Because it is the existence of disharmony among country tax regimes, and their relentless efforts to attract favoured economic activity away from other countries, that creates planning opportunities. In this regard, many of the reports issued under the BEPS project provide laundry lists of elements to be taken into account in specific contexts to ascertain appropriate tax results. Such lists also provide grist for the mill of tax planning.

Oddly enough, it may be that the intense focus on the BEPS project, and related matters evolving on a global basis, will have the result of driving planning and acquisition strategies toward a new generation planning opportunity. This is probably not an outcome that was anticipated.

In Part II of this series, the authors will address the anticipated tsunami of international tax disputes and the steps being taken to develop means of preventing logjams that serve the interests of neither government nor MNEs.