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Is the OECD/G20 BEPS Initiative Heading in the Right Direction? Some Forgotten (and Uncomfortable) Questions

This article critically analyses the scope of the OECD/G20 Base Erosion and Profit Shifting (BEPS) initiative and further raises some questions concerning the role played by certain long-standing paradigms underlying corporate income taxation in the BEPS phenomenon.

1. The OECD/G20 BEPS Report: Acknowledgement of a Problem and the OECD's Well-Intentioned Intervention

The severe economic and financial crisis has filled the newspapers with headlines proclaiming that multinational enterprises (MNEs) were not contributing sufficiently to the public revenues of the countries in which they were allegedly obtaining their profits. Beyond the evidence that these MNEs were subject to surprisingly low tax rates (a phenomenon whose causes are varied and complex), the studies revealed a growing disjunction between the places where the MNEs were carrying on their activities and the places where they were ultimately reporting their profits for tax purposes.[1]

In this context, the G20 mandated the OECD to lead the project known today as the Base Erosion and Profit Shifting (BEPS) initiative. A description of the concept of "base erosion and profit shifting" was followed by the promulgation of the two key objectives that the initiative wished to pursue. The first objective was the elimination of double taxation without giving rise to double non-taxation opportunities;[2] the second and primary objective was to provide domestic and international instruments "aiming at better aligning rights to tax with real economic activity".[3] Moreover, the OECD outlined the three pillars that were supposed to enlighten the path it was about to undertake: (1) the replacement of a competition-based paradigm by a collaborative-based one; (2) the importance of taking a holistic approach rather than ad hoc measures; and (3) the commitment to seek imaginative and ambitious solutions without abandoning pragmatism.[4]

2. The OECD/G20 BEPS Action Plan: Building a New Framework on Recycled Measures and a Few Prejudices

The monumental task entrusted to the OECD inevitably became trickier when the time came to identify the causes contributing to the BEPS phenomenon and further delineate the scope of the Action Plan to counteract it. In the author's point of view, the Action Plan[5] committed two mistakes that thwarted the opportunity to engage in the first genuine revision of the principles and rules of international taxation, whose origins date back to the early 20th century.

Firstly, the point of departure could be no other than an upfront acknowledgment that a clear crisis of rules had arisen. While the initial report on BEPS seemed to share this view,[6] the Action Plan somehow deviated from this approach. Without ignoring the imperative need to revise the rules, the Action Plan redirected its focus to the taxpayers once again to hold them accountable for what was happening.[7] As a result of this, the document made an inaccurate and certainly inappropriate use of certain legal terms as "artificiality" or "abuse",[8] while referring to vague expressions such as "aggressive tax planning"[9] that

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1. A. Ting, *iTax – Apple's International Tax Structure and the Double Non-Taxation Issue*, Brit. Tax Rev. 1, p. 45 (2014) demonstrated this phenomenon using the example of Apple and concluded that the Apple group had transferred its taxable profits to territories in which its economic activities were insignificant, while, at the same time, fully complying with the laws of the countries involved.
2. OECD, *Addressing Base Erosion and Profit Shifting – Report*, p. 53 (OECD 2013), International Organizations' Documentation IBFD [hereinafter: the *BEPS Report*].
3. Id., at p. 51.
4. Id., at pp. 60-62, from which these guidelines may be inferred. All of these were welcomed in Y. Brauner, *What the BEPS*, 16 Fla. Tax Rev. 2, p. 58 (2014).
5. OECD, *Action Plan on Base Erosion and Profit Shifting- Report* (OECD 2013), International Organizations' Documentation IBFD [hereinafter: the *Action Plan*].
6. OECD, *BEPS Report*, *supra* n. 2, at p. 5, where it is stated that: "While there clearly is a tax compliance aspect, as shown by a number of high profile cases, there is a more fundamental policy issue: the international common principles drawn from national experiences to share tax jurisdiction may not have kept pace with the changing business environment". In the same vein, *see* id, at p. 28, which reads: "Beyond cases of illegal abuses, which are the exception rather than the rule, MNEs engaged in BEPS comply with the legal requirements of the countries involved".
7. This is at least what the author infers from the reading of Actions 6 (prevent treaty abuse), 7 (prevent the artificial avoidance of PE status) and 12 (require taxpayers to disclose their aggressive tax planning arrangements) of OECD, *Action Plan*, *supra* n. 5.
8. For instance, the consideration of the behaviour set out in Action 7 as "artificial" is, to say the least, debatable.
9. An undefined expression that is commonly present in the various reports on the OECD/G20 BEPS initiative.

are devoid of any legal basis. In short, the Action Plan gave the impression that it sought to raise the standard required of the taxpayer from mere compliance with the letter and spirit of the laws to some sort of "exemplary" behaviour that would satisfy some sense of justice or morality.[10] The author believes that this approach is unfortunate and prone to generate severe problems from a legal certainty perspective.

Secondly, a truly genuine revision of the international tax legal framework needs to be conducted necessarily without any prejudices. Even though the BEPS Report promised to deliver an innovative, ambitious and holistic approach, it was soon discovered with disappointment that the Action Plan had pushed out of the negotiations a few principles of notorious importance. In the first place, the discussion on the distribution of tax jurisdiction between residence and source was dismissed. Instead, the Action Plan chose not to question the residence-source relationship or the traditional configuration of these principles, confining itself to "restore" taxation at both levels.[11] Similarly, the discussion on the separate tax treatment of entities belonging to the same group (the "separate entity approach"), together with the standard that has traditionally served as a corrective to counteract the profit shifting risks that arise in these scenarios (the arm's length standard)[12] was equally rejected.

A deeper analysis of the Action Plan and its outcomes reveals a two-speed project. On the one hand, some Actions give rise to an awkward sense of déjà vu, as they seem to merely dust off old OECD reports for the occasion.[13] This is, for example, the case with Actions 2,[14] 5,[15] 6,[16] 7[17] and 12.[18] Conclusive evidence that the OECD/G20 BEPS initiative has retrieved old measures to address the challenges identified in the BEPS Report is the fact that virtually all amendments that will be introduced in the post-BEPS OECD Model[19] are based on pre-existing Commentaries to the OECD Model[20] which, in turn, are the result of old OECD reports. This is particularly the case with regard to the proposed changes to articles 1.2 (application of a tax treaty to entities that are regarded as transparent for tax purposes),[21] 1.3 (saving clause in favour of the residence state),[22] 4.3 (tie-breaker rule for determining the residence for treaty purposes of dual-resident persons other than individuals),[23] 5.4 (anti-fragmentation provision),[24] 5.5 (refinement of the agency permanent establishment (PE) to address its loopholes),[25] 10.2 (the need to retain the ownership of shares for a certain period of time to be entitled to reduced withholding tax),[26] 13.4 (extension of the concept of shares)[27] and X (limitation on benefits (LOB) rule).[28] All these measures share an evident anti-avoidance character, thereby corroborating the position held above.

Conversely, the author observes a small group of Actions that did provide the "out of the box" thinking promised in the BEPS Report in the form of a few innovative standards with a global reach. This is particularly the case with Actions 1, 13 and 15. Action 1 called into question one of the classic pillars of international taxation (the PE) in light of the challenges posed by the digital economy.[29] For its part, Action 13 was a response to a long-standing initiative promoted by non-governmental organiza-

10. Inasmuch as OECD, *Action Plan*, *supra* n. 5, intends to attribute some form of legal repercussions to the behaviours covered by the expression "aggressive tax planning", it appears to be demanding that taxpayers structure their business operations in such a way that the subsequent tax liabilities result in a proper contribution to the public expenditure of the countries involved.
11. OECD, *Action Plan*, *supra* n. 5, at p. 11, where it is stated that: "While actions to address BEPS will restore both source and residence taxation in a number of cases ... these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income". Action 1 was the only exception to this rule (*see* section 3.5.).
12. Id., at p. 14, which reads: "There is consensus among governments that moving to a system of formulary apportionment of profits is not a viable way forward; it is also unclear that the behavioural changes companies might adopt in response to the use of a formula would lead to investment decisions that are more efficient and tax-neutral than under a separate entity approach". In fact, Actions 8 to 10 were specifically intended to update the interpretation of the arm's length standard.
13. Brauner, *supra* n. 4, at p. 60, was not mistaken when he warned against the potential risk that a tight two-year deadline could result in the OECD resorting to the ad hoc measures that had been proposed in previous reports.
14. OECD, *The Application of the OECD Model Tax Convention to Partnerships* (OECD 1999), International Organizations' Documentation IBFD; OECD, *Corporate Loss Utilization through Aggressive Tax Planning* (OECD 2011); and OECD, *Hybrid Mismatch Arrangements: Tax Policy and Compliance Issues* (OECD 2012), International Organizations' Documentation IBFD.
15. OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD 1998).
16. OECD, *Double Taxation and the Use of Conduit Companies* (OECD 1986), International Organizations' Documentation IBFD; OECD, *Restricting the Entitlement to Treaty Benefits* (OECD 2003); OECD, *Tax Treaty Issues Related to REITs* (OECD 2008); and OECD, *The Granting of Treaty Benefits with respect to the Income of Collective Investment Vehicles*(OECD 2010), International Organizations' Documentation IBFD.
17. OECD, *Issues Arising under Article 5 (Permanent Establishment) of the Model Tax Convention* (OECD 2002), International Organizations' Documentation IBFD.
18. OECD, *Tackling Aggressive Tax Planning through Improved Transparency and Disclosure* (OECD 2011) and OECD, *Co-Operative Compliance: A Framework from Enhanced Relationship to Co-Operative Compliance* (OECD 2013).
19. *OECD Model Tax Convention on Income and on Capital* (26 July 2014), Models IBFD.
20. *OECD Model Tax Convention on Income and on Capital: Commentaries* (26 July 2014), Models IBFD.
21. Para. 5 *OECD Model: Commentary on Article 1* (2014). Revised by Action 2.
22. Paras. 6.1 and 23 *OECD Model: Commentary on Article 1* (2014) and para. 14 *OECD Model: Commentary on Article 7* (2014). Revised by Action 6.
23. Para. 24.1 *OECD Model: Commentary on Article 4* (2014). Revised by Action 6.
24. Para. 27.1 *OECD Model: Commentary on Article 5* (2014). Revised by Action 7.
25. Id., at para. 32.1. Revised by Action 7.
26. Paras. 16 and 17 *OECD Model: Commentary on Article 10* (2014). Revised by Action 6.
27. Para. 28.5 *OECD Model: Commentary on Article 13* (2014). Revised by Action 6.
28. Para. 20 *OECD Model: Commentary on Article 1* (2014). Revised by Action 6.
29. Despite its apparent novelty, the OECD had published a few reports on the subject. *See*, for example, OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* (OECD 2001) and OECD, *E-commerce: Transfer Pricing and Business Profits Taxation* (OECD 2005), International Organizations' Documentation IBFD.

tions (NGOs) for decades, i.e. country-by-country (CbC) reporting. CbC reporting aimed at providing a comprehensive overview of the presence of MNEs throughout the world, segregating the information (e.g. economic activities, taxable profits or taxes paid) by jurisdiction. Finally, Action 15 aimed at making a leap towards a multilateral forum in which all jurisdictions sharing the concerns expressed in the OECD/G20 BEPS initiative are equally welcome to participate on an equal footing.

Notwithstanding the good impression generated by these last three Actions, it can be concluded that the BEPS Action Plan has failed to meet the expectations created by the BEPS Report for all the reasons stated above. The author suspects that the reasons behind this shift have little to do with lack of vision or incompetence but rather relate to a growing disinterest among the sponsors of the OECD/G20 BEPS initiative (i.e. the governments of the OECD and G20 member countries) that did not dare to undertake what could have been a genuine substantial revision of a system forged in the early 20th century.[30]

3. The Appropriateness of Raising Questions That Far Exceed the Scope of the BEPS Action Plan

3.1. Introductory remarks

As anticipated in section 2., the BEPS Action Plan omitted a number of questions of a more fundamental nature. As a result, there have been multiple debates running in parallel to the development of the OECD/G20 BEPS initiative that have called into question some of the long-standing paradigms that the OECD regarded as untouchable. Such discussions have not only taken place in academic fora, but also within international organizations other than the OECD.

The author now proceeds to raise a few questions (*see* sections 3.2. to 3.6.) which, in her opinion, deserve greater consideration.

3.2. Should income continue to be taxed at the level of the companies?

This is the most fundamental question of all and, thus, the first one that ought to be addressed. As taxing the income in the hands of the companies has proven to be so troublesome, would it not make sense to abolish corporate income taxation and instead tax income in the hands of the individuals behind the company?

Companies are nothing more than fictions created by the law, which, in turn, confers on them a legal personality analogous to that enjoyed by natural persons. This is a status that entails the capacity to hold both rights and obligations. The origin of companies goes back to the Industrial Revolution, and their historical purpose was no other than to serve as investment vehicles that protected investors by way of a limitation on their potential liabilities in the event of losses.[31] At this point, jurisdictions chose to extend their income taxes to these new legal subjects, most probably driven by inertia rather than a clear policy purpose.

That said, the decision to tax the income in the hands of the company has always been controversial. It is rare to find an economist who supports the existence of corporate income taxes (hereinafter CITs),[32] and quite a few tax experts have similarly criticized them. Some of the problems posed by CITs will now be briefly highlighted.

In general, all taxes tend to be inefficient, discourage economic activity and lead to distortions in the decision-making process of taxpayers. Naturally, CITs are no exception to this rule. In particular, CITs are likely to condition decisions concerning the choice of business sector, the organizational form (the incorporation decision), the location of the activities, the company's capital structure (debt:equity ratio), the dividend policy, etc.[33] In addition, it is no secret that CITs often generate such a large amount of costs and such a high degree of legal uncertainty with regard to the ultimate tax implications of the business decisions that they may dissuade potential investors or entrepreneurs from investing, initiating, maintaining or expanding a business activity.

CITs could be forgiven for the problems stemming from their implementation to the extent it could be concluded that their advantages effectively offset their drawbacks. In this regard, there is a widespread assumption that CITs are inherently fair, insofar as they contribute to redistributing wealth from the companies (symbols of wealth and power) to the less privileged social classes.[34] However, multiple studies have dispelled this myth, concluding that CITs do not necessarily help to redistribute wealth in the way they are expected to do.

For a better understanding of how redistribution works in corporate income taxation, the first question that arises is who is affected by the payment of these taxes. Even though companies are the nominal taxable subjects of the tax, as they are mere legal fictions, they are not the ones ultimately bearing the tax burden. Rather, it is those individuals who are tangentially linked to the companies that do. The next question that arises is which individuals are affected by the payment of the CITs, as companies make such payments with funds that would otherwise have served other purposes. Empirical studies have concluded that CITs are ultimately borne by three differ-

30. The reactionary attitude of countries, such as the United States, to the measures proposed by the OECD/G20 BEPS initiative is well known. In this context, L. Sheppard, *International Changes the United States Shouldn't Have Made*, 76 Tax Notes Intl. 7, p. 563 (2014), describes the US stance on base erosion and profit shifting as a "polite pretense of participation with quiet undermining".

31. For more on the historical origin of companies, *see* P.A. Harris, *Corporate/Shareholder Income Taxation and Allocating Taxing Rights between Countries: A Comparison of Imputation Systems* pp. 40-41 (IBFD 1996).

32. *See*, for example, the position adopted by the Nobel Prize-winning professor of economics William Spencer Vickrey in W. Vickrey, *The Corporate Income Tax and How to Get Rid of It*, in *Retrospectives on Public Finance* (L. Eden, ed., Duke U. Press 1991).

33. R. Bird, *Why Tax Corporations?*, 56 Bull Intl. Fiscal Docn. 5, sec. 1. (2002), Journals IBFD.

34. Bird, *supra* n. 33, at sec. 1.2. and Y. Brauner, *The Non-Sense Tax: A Reply to New Corporate Income Tax Advocacy*, 4. Michigan State L. Rev. 1, p. 592 (2008).

ent groups of individuals: (1) shareholders (as a result of a decrease in their invested capital);[35] (2) employees (by way of a reduction in their pay);[36] and (3) consumers (through an increase in prices).[37] In particular, globalization may have aggravated the burden for the less mobile individuals, i.e. employees.[38]

This revelation calls into question the wealth redistributive role supposedly played by CITs, as the tax revenues do not appear to flow from the "prosperous powerful" corporations, but rather from their shareholders, clients and, primarily, employees. At this point, it should be noted that most tax systems already subject to tax the ability to pay expressed by these groups of individuals, generally both directly and indirectly.[39] As a result, it seems that wealth redistribution systems of jurisdictions with CITs in place tend to penalize unjustifiably these groups of individuals, as they are compelled to contribute to their national budget by means of a considerable number of tax instruments, CITs among them.

What is more, if we regarded those who ultimately bear the burden of CITs as the true taxpayers, it could hardly be argued that these CITs are consistent with the ability-to-pay principle. The reason is that the calculation of the tax liability in CITs tends to rely solely on the amount of net profits obtained by the company during the tax period concerned, irrespective of the particular ability to pay of the individuals (whether shareholders, clients or employees) who are deemed to bear the tax burden at the end of the day. Accordingly, such tax burden would fall equally on all these individuals regardless of their economic positions.

In conclusion, it would be easier to accept the aforementioned pernicious effects of CITs insofar as they could be regarded as effective wealth redistribution tools.

However, if this myth is dismissed, it appears to be difficult to maintain the usefulness of these taxes. This also appears to be particularly ironic in the context of the OECD/G20 BEPS initiative, as the discourse of the media, the NGOs and the OECD itself has revolved around the notions of equity, wealth redistribution and paying a "fair share".[40]

For these reasons, some have recently pleaded for the abolishment of CITs and their replacement by a mechanism that would turn the company into a mere withholding agent responsible for the collection of the income tax imposed on the individual shareholders.[41] In other words, this would be a tax transparency system preventing tax deferral with regard to the income accumulated by companies. Such a system presents major challenges, one of them being the identification of the individual shareholders behind the corporate veil. Nowadays, information on the ownership of companies is rarely public, although the OECD intends to make some progress in this regard, as it recently stated that one of its next priorities is to "address the question of beneficial ownership (…) identify the natural persons behind the companies, trusts and other arrangements".[42]

Notwithstanding the aforementioned, the abolishment of CITs is currently an unattainable chimera. This is mainly because the citizenship (and by extension its political representatives) feel that such taxes are both useful and fair, no matter how much these assumptions are based on unfounded intuitions.[43] Consequently, in leaving aside the preservation of CITs, the author now poses some additional questions regarding the fundamental pillars on which they are based (*see* sections 3.3. to 3.6.).

3.3. Is it reasonable to insist on the separate entity approach in a globalized world?

Assuming that CIT is maintained, the second question that arises is who should be regarded as its taxpayer. Nowadays, each company is typically treated as a separate taxable subject, irrespective of its membership of a functionally integrated corporate group, while its taxable base is usually calculated on the basis of its accounts. This approach poses evident profit shifting risks that tend to be corrected by means of the arm's length principle, which adjusts the conditions agreed in intra-group transactions so that the taxable base of the company concerned includes the profits that it would have obtained if the transaction had been carried out with an unrelated party.

In past decades, many parties have raised objections to these paradigms, pleading instead for a formulary system that regards the MNE as a sole taxpayer, consolidating its profits and distributing them among the different group entities for tax purposes using a pre-established formula.[44] The reasons are varied but quite convincing.

The main argument stems from the very raison d'être of MNEs. While they comprise a network of separate compa-

35. A.C. Harberger, *The Incidence of the Corporation Income Tax*, 70 J. Political Econ. 3, pp. 215-240 (1962), recently reviewed by A.J. Auerbach, *Who Bears the Corporate Tax? A Review of What We Know*, 20 Tax Policy & Econ., p. 33 (2006).
36. W. Arulampalam, M. Deveraux & G. Maffini, *The Direct Incidence of Corporate Income Tax on Wages*, Working Paper 09/2007 (Oxford U. Ctr. Bus. Taxn.).
37. M. Krzyzaniak & R.A. Musgrave, *The Shifting of the Corporation Income Tax* (Johns Hopkins U. Press (1963).
38. H. Grubert & J. Mutti, *The Taxation of Capital Income in an Open Economy: The Importance of Resident-Nonresident Tax Treatment*, 27 J. Pub. Econ. 3, pp. 291-309 (1985).
39. Generally by means of direct taxes (e.g. personal income taxes) or indirect taxes (e.g. value-added taxes).
40. There are multiple references to the principle of fairness in the BEPS Report. *See* OECD, *BEPS Report*, *supra* n. 2, at pp. 37, 48, 49 and 50. *See also* R. Russo & P. Saint-Amans, *OECD: What the BEPS Are We Talking About?*, 70 Tax Notes Intl. 4, pp. 339-340 (2013) and *The BEPS Package: Promise Kept*, 70 Bull. Intl. Taxn. 4, secs. 1. and 4. (2016), Journals IBFD.
41. Brauner, *supra* n. 34, at pp. 635-636.
42. OECD, *Tax Transparency 2016: Report on Progress*, Global Forum on Transparency and Exchange of Information for Tax Purposes, p. 5 (OECD 2016).
43. Bird, *supra* n. 33 and Brauner, *supra* n. 34, at pp. 593 and 635. In contrast, other scholars still advocate for the maintenance of corporate income taxes. *See*, for example, R.S. Avi-Yonah, *Corporations, Society and the State: A Defense of the Corporate Tax*, 90 Va. L. Rev. 5, pp. 1193-1255 (2004).
44. *See*, for example, R.S. Avi-Yonah & K.A. Clausing, *Reforming Corporate Taxation in a Global Economy: A Proposal to Adopt Formulary Apportionment*, The Hamilton Project Discussion Papers (2007).

nies and branches, in practice they all work as components of a single gear subject to common control. The possibility of internalizing business processes rather than relying on third parties proves to be more efficient and cost effective from both an organizational and economic perspective,[45] as it helps to reduce the costs resulting from market inefficiencies, such as the operating costs or risks relating to the trust in the counterparty (e.g. quality control or the protection of sensitive information).[46] Furthermore, by internalizing business processes, MNEs can achieve economies of scale and thus generate synergies that ultimately result in greater profits than those that could have been obtained in the market. Such profits would naturally fall outside the scope of the arm's length principle, as they would have never occurred under market conditions.[47] As a consequence, the consolidation of all profits obtained by the group for tax purposes appears to align better with the economic and organizational reality of the group.[48]

The second argument relates to the huge administrative burden and compliance costs that the application of the arm's length principle involves. The system consumes a disproportionate amount of both public[49] and private resources, as it has created from scratch a huge industry of lawyers, accountants and economists who assist MNEs in complying with the arm's length standard.[50] At this point, it should be noted that nearly 60% of the transactions carried out globally are intra-group[51] and thus subject to the application of this standard. The inherent complexity of this system undoubtedly favours those who are better equipped in terms of resources, resulting in a two-speed system, divided between those who have such resources (MNEs supported by large firms) and those who do not (small and medium-sized enterprises (SMEs) and tax administrations in developing countries).[52]

Alternatives to this widespread approach have made their way into the legislation of some countries in recent decades. Some jurisdictions have included tax consolidation regimes in their domestic legislations,[53] although their scope is almost invariably limited to resident entities belonging to the group or, at most, the PEs of non-resident companies that are located within the territory of the jurisdiction concerned.[54] Federal states, such as Canada and the United States, not only consolidate the profits of their groups, but also apply formulas to distribute them among the different regions where the group carries out its economic activities. However, initiatives regarding tax consolidation and apportionment have rarely crossed the frontier of the jurisdiction concerned. The only attempt in this regard was led by the European Union in 2011 with its proposal on the Common Consolidated Corporate Tax Base (CCCTB) (*see* section 3.6.).

For its part, the OECD has chosen to remain faithful to both the separate-entity approach and its widespread corrective, the arm's length principle, thus corroborating its historical opposition to abandoning or even questioning these paradigms. However, the OECD did implicitly admit that the achievement of the BEPS mantra (i.e. the alignment between taxing rights and economic activity) necessarily required going beyond the arm's length standard[55] and moving closer to formulary measures. This may be inferred from the final report on the Actions concerning transfer pricing, as the OECD resolutely promoted profit split over the remaining methods (particularly in the context of intangibles). This method resembles formulary apportionment to a certain extent, as it aggregates all the profits derived from a transaction to subsequently distribute them among the entities that have presumably contributed to generate the profits.[56] In scenarios involving intangible assets, BEPS opts for attributing the profit to the group entities that have performed the most important functions related to the intangible, i.e. development, enhancement, maintenance, protection and exploitation.[57]

3.4. Must corporate tax residence tests be revisited?

Departing from the preservation of CIT and the consideration of each entity belonging to a group as a separate taxable subject, the author now proceeds to call into question another paradigm that has been, intentionally or inadvertently, left outside the scope of the BEPS Action Plan.

Jurisdictions must define the conditions under which a taxpayer will "reside" for tax purposes in their territory and consequently be subject to an unlimited tax liabil-

45. R.H. Coase, *The Nature of the Firm*, 4 *Economica* 16, pp. 386-405 (1937).
46. M.F. de Wilde, *Sharing the Pie: Taxing Multinationals in a Global Market* pp. 162-163 (Rotterdam Erasmus U. 2015).
47. L.E. Schoueri, *Arm's Length: Beyond the Guidelines of the OECD*, 69 Bull. Intl. Taxn. 12, sec. 5.3. (2015), Journals IBFD.
48. S. Mayer, *Formulary Apportionment for The Internal Market*, IBFD Doctoral Series No. 17 p. 178 (IBFD 2009), Online Books IBFD.
49. It has been estimated that the costs of transfer pricing disputes in United States are three to seven times higher than the costs of implementing a domestic formulary apportionment regime. *See* D.R. Bucks & M. Mazerov, *The State Solution to the Federal Government's International Transfer Pricing Problem*, 46 Natl. Tax J. 3, pp. 385-392 (1993).
50. Y. Brauner, *Formula Based Transfer Pricing*, 42 Intertax 10, p. 627 (2014), who states that: "the transfer pricing regime has created from scratch a large, economically wasteful industry which exists only to serve the need to supply these particular valuations".
51. J. Owens, *Should the Arm's Length Principle Retire?*, 12 Intl. Transfer Pricing J. 3, secs. 1.-5. (2005), Journals IBFD.
52. Avi-Yonah & Clausing, *supra* n. 44, at p. 15 and OECD, *Two-Part Report to G20: Developing Working Group on the Impact of BEPS in Low Income Countries* (OECD 2014).
53. Y. Masui, *General Report*, in *Group Taxation*, International Fiscal Association (IFA) *Cahiers de droit fiscal international*, vol. 89b, secs. 2.1.1.1. and 2.1.1.2 (Sdu Fiscale & Financiële Uitgevers 2004), Online Books IBFD, according to whom, of the 30 surveyed countries, 20 had a consolidation regime and most of the remaining were inclined to consider its implementation.
54. Id., at sec. 3.2.4., i.e. only Denmark, France and Italy have extended their regimes to include non-resident entities.
55. OECD, *Action Plan*, *supra* n. 5, at p. 20.
56. Schoueri, *supra* n. 47, secs. 2.5.2. and 2.5.3. There are two substantial differences between formulary apportionment and the profit split method. First, while the formula consolidates the global profit realized by the group, profit split only aggregates the result of a particular transaction. Second, while formula apportionment distributes the profit using factors predetermined in a rule, profit split uses the criteria that would have presumably been adopted by independent parties.
57. OECD, *Actions 8-10 Final Report 2015 – Aligning Transfer Pricing Outcomes with Value Creation* (OECD 2015), International Organizations' Documentation IBFD.

ity on its worldwide income.[58] In the case of individuals, they have the ability to reside in a given location, which may be deduced from the analysis of visible facts, such as their physical presence or their personal or economic ties to the country concerned. In this context, tax residence rules tend to rely on some of these factors. Conversely, it is not in the nature of companies to reside in any given place. As a consequence, jurisdictions have no alternative other than to resort to artificial criteria whose fulfilment results in deeming the entity a resident therein.

The most common criteria used by jurisdictions to confer corporate residence for tax purposes may be classified into four different groups:[59] (1) formal tests (e.g. place of incorporation, legal seat or registered office); (2) tests that rely on the place where the company is run (e.g. place of effective management or central management and control); (3) tests that refer to the place where the company carries on its economic activity; and (4) tests that refer to the residence of its shareholders. The comparative study conducted by the OECD on the corporate residence tests used in 53 jurisdictions[60] reveals that 85% employ test (1) and 77% use test (2), while only 4% and 2% opt for tests (3) and (4), respectively. In any case, the vast majority of jurisdictions have two tests in place, typically a combination of tests (1) and (2).

To date, tax treaties have never interfered in the way in which jurisdictions confer tax residence status on their companies, so this matter has traditionally been left to the sole discretion of the sovereign state.[61] For their part, tax treaties have confined themselves to the resolution of double residence issues, i.e. situations where the same taxpayer is regarded as tax resident in both contracting states. This determination is decisive to the extent treaties depart from the assumption that only one of the contracting states acts as the "residence state". While the BEPS Action Plan does not alter this status quo,[62] it does provide a rule that is tangentially related to the domestic definition of corporate tax residence.

The OECD Model (2014) makes the application of a tax treaty conditional on the fulfilment of two requirements: (1) a person must be regarded as tax resident in at least one of the contracting states (articles 1 and 4); and (2) a person must be subject to a tax on its income or capital imposed by at least one of the contracting states. As noted previously in this section, the qualification of a person as "tax resident" is exclusively determined by the relevant state, although the OECD Model (2014) would only respect such considerations for the purposes of a tax treaty insofar as the resident is liable to full tax liability that goes beyond income derived from sources of the residence state. Once both conditions are met, a taxpayer would be a priori entitled to the benefits of the treaty.

The OECD/G20 BEPS initiative concluded that the aforementioned requirements were insufficient, as they resulted in the granting of treaty benefits in circumstances that were regarded as "inappropriate".[63] With this, the OECD was alluding to the phenomenon commonly known as "treaty shopping", which involves scenarios in which a resident of a third state seeks to gain access to the benefits of a tax treaty concluded between two contracting states, typically by way of an intermediary entity that complies with the conditions established in articles 1 and 4 of the OECD Model.

In this context, the Final Report on Action 6 proposed the addition of a new article to the OECD Model that would effectively help to raise the threshold for treaty entitlement by means of an LOB clause (inspired in the US clause) and/or a principal purpose test (PPT) rule.[64] An LOB clause can be broadly defined as a rule that imposes additional requirements for a resident of a contracting state to enjoy treaty benefits.[65] What these requirements have in common is that they all intend to guarantee that the resident entity is substantially and sufficiently linked to the state that grants the status of tax resident, either because its shares are regularly traded on a local stock exchange or because, inter alia, it actively carries on business activities within its territory or the majority of its shareholders are residents there.

At this point, the question arises as to whether the need to resort to certain anti-treaty shopping measures ultimately reveals a systemic mistrust towards the criteria that have traditionally served to grant the tax resident status. In other words, the fact that these criteria are easy to manipulate and do not ensure a genuine connection between the company and its residence states makes it necessary to resort to anti-treaty shopping measures, as these contribute to neutralizing such weaknesses. This being so, should the OECD consider the possibility of becoming involved in this matter? For example, bearing in mind that purely formal criteria are more likely to generate problems from

58. Beyond notable exceptions, such as Costa Rica and as France, which have a territorial tax system and, therefore, tax residence is, a priori, irrelevant.
59. L. De Broe, *Corporate Tax Residence in Civil Law Jurisdictions*, in *Residence of Companies under Tax Treaties and EC Law* (G. Maisto ed., IBFD 2009), Online Books IBFD.
60. OECD, *Rules Governing Tax Residence* (OECD), available at www.oecd.org/tax/automatic-exchange/crs-implementation-and-assistance/tax-residency/ (accessed 18 Nov. 2016).
61. This is true in the three most influential models, i.e. the *OECD Model* (2014), *UN Model Double Taxation Convention between Developed and Developing Countries* (1 Jan. 2011), Models IBFD and *US Model Tax Convention on Income* (17 Feb. 2016), Models IBFD. In fact, paragraph 4 of the *OECD Model: Commentary on Article 4* (2014) confirms this position, where it is stated that: "conventions for the avoidance of double taxation do not normally concern themselves with the domestic laws of the Contracting States laying down the conditions under which a person is to be treated fiscally as 'resident' and, consequently, is fully liable to tax in that State. They do not lay down standards which the provisions of the domestic laws on "residence" have to fulfil in order that claims for full tax liability can be accepted between the Contracting States. In this respect the States take their stand entirely on the domestic laws."
62. Beyond the proposal to amend article 4(3) of the *OECD Model* (2014) and to replace the tie-breaker rule, i.e. the POEM, with a remission to a mutual agreement procedure (MAP). *See* OECD, *Action 6 Final Report 2015 – Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* pp. 72-75 (OECD 2015), International Organizations' Documentation IBFD.
63. OECD, *Action Plan*, *supra* n. 5, at pp. 18-19.
64. OECD, *supra* n. 62, at pp. 17-69.
65. J.D. Bates et al. *Limitation on Benefits Articles in Income Tax Treaties: The Current State of Play*, 41 Intertax 6/7, p. 395 (2013).

a treaty shopping perspective,[66] should jurisdictions be advised against its use? Should article 4.1 of the OECD Model reject these as valid criteria for the purposes of a tax treaty?

3.5. Is the update of the PE concept both convenient and feasible?

Having analysed the way in which jurisdictions confer the resident status on companies in their CITs, the author now proceeds to challenge the other side of the coin: the definition of source.[67] Just as the ability to reside in a place was not a natural attribute of companies and it was therefore necessary to establish a legal convention the satisfaction of which resulted in the consideration that a company resides in a jurisdiction for tax purposes, a similar problem is encountered in determining the source of an item of income. As source is not a concept that can be inferred from the nature of things,[68] the legislator finds himself again in the position of drafting a rule that places the source of a given item of income in a certain state, which in turn may claim the right to tax the income in question.

Tax treaties have always relied on the same legal convention when it comes to identifying those cases in which a contracting state may tax the business profits realized by a resident of the other contracting state.[69] This convention is the PE in its three forms, i.e. (1) a fixed place of business; (2) a construction PE; and (3) a dependent agent PE.[70] It was then held that the fulfilment of these requirements reveals that the non-resident taxpayer is effectively integrated into the economic life in the host state to the extent that the latter can legitimately assert its taxing rights over the profits that could be attributed to such a PE.[71]

Undoubtedly, the PE is the natural consequence of the economic context in which it arose, when physical presence was decisive in conducting any kind of economic activity, including the provision of services. In such a scenario, the PE appeared to be the ideal parameter by which to measure the degree of participation of a non-resident taxpayer in the economic life of the host state. However, business models have evolved in a way that the correlation between physical and economic presence has been significantly weakened. Advances in transport and communications, the automation of certain functions and the popularization of the Internet with the consequent expansion of electronic commerce and the remote provision of services are some of the long list of milestones that have resulted in the question of whether economic presence in a given state should continue to be measured solely by means of a parameter entirely based on a physical and tangible presence.[72]

The OECD/G20 BEPS initiative has devoted two actions to the PE concept: one aimed at its enhancement (Action 7)[73] and the other at its rethinking (Action 1).[74] The latter action endorsed some of the aforementioned concerns[75] and questioned whether the PE concept is still consistent with the principles upon which it was originally based, particularly considering that non-resident taxpayers are increasingly able to become closely involved in the economic life of the host state without having a PE there.[76]

The Final Report on Action 1 provided three proposals aimed at mitigating the inherent limitations of the PE concept in a very different economic scenario to that in which it originated.[77] The first proposal is a nexus of "significant economic presence" comprised of various alternative tests that represent some of the business strategies adopted by the technological enterprises. The Final Report recommends a combination of a revenue-based factor together with a second indicator based either on the digital presence of the company (through a local domain name or digital platform) or the volume of active users or data collected.[78] The second proposal involves subjecting digital transactions to a gross-basis withholding tax at source,[79] either as an autonomous measure or as a collecting mechanism that facilitates the enforcement of the first proposal. Finally, the third alternative entails the adoption of an "equalization levy" aimed at ensuring equal treatment of resident and non-resident suppliers. India

66. It should be noted that only 17% of the surveyed countries of the comparative study (*see supra* n. 60) only have formal criteria in place.
67. Many of the issues that are discussed further in section 3.5. are covered in E. Escribano, *An Opportunistic, and yet Appropriate, Revision of the Source Threshold by the Twenty-First Century Tax Treaties*, 43 Intertax 1, pp. 6-13 (2015).
68. K. Vogel, *Worldwide vs Source Taxation of Income: A Review and Re-Evaluation of Arguments (Part I)*, Intertax 8-9, p. 223 (1988).
69. The concept of a PE can already be found in *Austria-Hun.-Prussia Tax Treaty* (1899), which is considered as the first tax treaty ever concluded. This tax treaty may have been inspired by the concept of *Betriebsstätte* (fixed establishment) in Prussian legislation. *See* A. Skaar, *Permanent Establishment: Erosion of a Tax Treaty Principle* p. 72 (Kluwer L. & Taxn. 1991).
70. All three methods are embodied in article 5 of the *OECD Model* (2014), the *UN Model* (2011) and the *US Model* (2016). The *UN Model* (2011) one also includes a "service PE" in article 5(3)(b).
71. Skaar, *supra* n. 69, at p. 559, who states that: "The conventional wisdom is that an enterprise with a foreign PE has extended its activities abroad to such a degree that the benefits from this country´s expenditure networks justify taxation in that country". In the same vein, *see* paragraph 11 of the *OECD Model: Commentary on Article 7* (2014), which reads: "(it) reflects the international consensus that, as a general rule, until an enterprise of one Estate has a permanent establishment in another State, it should not properly be regarded as participating in the economic life of that other State to such an extent that the other State should have taxing rights on its profits".
72. Escribano, *supra* n. 67, at pp. 8-9.
73. OECD, *Action 7 Final Report 2015 – Preventing the Artificial Avoidance of Permanent Establishment Status* (OECD 2015), International Organizations' Documentation IBFD.
74. OECD: *Action 1 Final Report 2015 – Addressing the Tax Challenges of the Digital Economy* (OECD 2015), International Organizations' Documentation IBFD.
75. Id., at pp. 79 and 100, which literally recognize that a non-resident company can today interact with customers in a state remotely through a website or a mobile app without maintaining a physical presence in the state. It is observed that companies can currently expand their customer base in a state with few or no infrastructures and personnel.
76. Id., at p. 101.
77. Id., at pp. 107-117.
78. This test departs from the assumption that the number of users of a platform or the volume of personal and commercial data which companies can extract from them constitutes a fundamental asset for technological enterprises. This idea was originally advance by the report presented by Pierre Collin and Nicolas Colin to the French Ministry of Finance in 2013, in respect of which it was concluded that the concept of PE should be able to reflect the value provided by the users by means of their data.
79. This draft is partially based on Y. Brauner & A. Baez, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy*, IBFD White Papers (IBFD 2015).

has already opted for this, although its scope differs from that proposed by the OECD.[80]

Clearly, the three proposals are still in an embryonic stage, as the Final Report on Action 1 does not provide a normative draft and barely specifies their contents and scope. This may be interpreted as a symptom of other far-reaching problems. The first one is the apparent political disinterest in a substantial modification of the term.[81] The second probable obstacle, and perhaps the hardest to overcome, is the tremendous difficulty in translating a general idea of how a PE should be constituted into a legal rule that not only serves the intended policy purpose effectively but is also manageable, difficult to circumvent and compatible with the current legal framework. The OECD itself warned against a number of challenges and risks posed by each one of the three proposals,[82] giving the impression that a formula that satisfactorily meets the aforementioned requirements is far from being agreed.

3.6. Is the complete reformulation of corporate income tax the only way forward?

While the OECD drafted the rules requested by the BEPS Action Plan, scholars were working in parallel on new normative solutions to counteract base erosion and profit shifting risks. A few of these scholars share the feeling that CITs involve so many structural problems that resolving these necessarily requires a substantial reformulation of the relevant policy objectives, founding principles and design of the tax. As a result, a number of proposals have been advanced, whether completed or ongoing, that intend to lay the basis for a true reformulation of CITs. This article considers two of them.[83]

The first proposal that should be highlighted is the CCCTB, a project that suggests group consolidation for tax purposes and a subsequent distribution of the profits according to a formula based on sales, labour and assets.[84] The European Union chose to re-initiate this project following its initial failure in 2011, although with two important novelties.[85] This time, the CCCTB is not conceived as an elective regime, at least not for MNEs whose global turnover exceeds EUR 750 million a year, as such MNEs would be obliged to apply the regime. The second difference is that the Commission has proposed a progressively phased implementation. To this end, the first two steps (common tax base and consolidation) were put into motion in October 2016,[86] thus postponing the negotiation on the formula apportionment.[87] Beyond the EU proposal, group consolidation and formulary apportionment have been (and still are) considered by a large number a scholars, who have greatly contributed to highlighting the advantages and shortcomings that this innovative regime may pose in practice.[88]

The second proposal is the destination-based corporate tax[89] (hereinafter DBCT), which originated within the framework of a research project led by the Oxford University Centre for Business Taxation. In essence, the proposal was for a replacement of current CITs by the DBCT. Its tax base would depart from the company's cash flow, thereby including net financial inflows and allowing the immediate expensing of all investment expenditure. It intends to tax the corporate profit at destination, which, for the purposes of this regime, will be interpreted as the residence of the final customer. The DBCT is clearly inspired by value-added taxes, as exports would be tax exempt, while imports would be taxed.

Both proposals entail a substantial departure from the paradigms that have been called into question here. In the first place, the implementation of the CCCTB would imply the abandonment of the separate entity approach and the arm's length standard and, by extension, the erad-

80. The Indian equalization levy came into force on 1 June 2016. A. Mehta, *"Equalization Levy" Proposal in Indian Finance Bill 2016: Is It Legitimate Tax Policy or an Attempt of Treaty Dodging?*, 22 Asia-Pac. Tax Bull. 2 (2016), Journals IBFD analysed the functioning of the levy and its questionable compatibility with the Indian treaty network.
81. Danielle Rolfes, the US Treasury International Tax Counsel has asserted that: "Treasury will not countenance fundamental changes to the permanent establishment rules, which other countries clearly want … some tweaking of the PE rules may be warranted … any tweaking should not take the form of a digital commerce PE", as quoted in D. Spencer, *The OECD BEPS Project: Tax Challenges of the Digital Economy (Part 1)*, 25 J. Intl. Taxn. 1, pp. 30-41 (2014).
82. These three proposals have important weaknesses from the perspective of management, i.e. particularly the revenue-based factor and the volume of users and/or data collected of the user-based factor from the "significant economic presence" nexus and the withholding tax in respect of the difficulties in collecting it, the possibilities for circumvention, i.e. the digital factors test of the "significant economic presence" nexus, the generation of undesirable asymmetries, i.e. the withholding tax and the equalization levy, and their questionable compatibility with the legal framework in place, i.e. the "significant economic presence" nexus would require amendment of the attribution rules of the equivalent of article 7 of the *OECD Model* (2014) in the tax treaties, while the withholding tax could infringe EU law and the General Agreement on Tariffs and Trade (GATT), and the equalization levy could equally violate EU law.
83. Proposals that were identified as appropriate "long-term policy options" by the report on taxation of the digital economy of the Commission Expert Group, *Report of the Commission Expert Group on Taxation of the Digital Economy* pp. 49-50 (May 2014).
84. European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (Com 2011/0058), EU Law IBFD.
85. The initiative took place within the framework of the EU Action Plan for a Fair and Efficient Corporate Taxation. The differences from the 2011 project are highlighted in T. Maguire, *CCCTB: The Sequel*, 28 Irish Tax Rev. 3, pp. 107-113 (2015).
86. European Commission, Proposal for a Council Directive on a Common Corporate Tax Base (Com 2016) and European Commission, Proposal for a Council Directive on a Common Consolidated Corporate Tax Base (Com 2016). For his part, E. Röder, *Proposal for an Enhanced CCTB as Alternative to a CCCTB with Formulary Apportionment*, 4 World Tax J. 2 (2012), Journals IBFD has stated that the European Union should only introduce the first phase of this action plan, i.e. the common tax base.
87. J. Müller, *Why Europe needs 3CTB to Get Ahead* (Kluwer Intl. Tax Blog 2015).
88. T. Albin, *International Aspects of the CCCTB in Europe* (Océ Business Services 2014), which is a PhD thesis that has provided comprehensive insight into formulary apportionment from an EU perspective. *See also* C.E. Mclure (Jr), *Replacing Separate Entity Accounting and the Arm's Length Principle with Formulary Apportionment*, 56 Bull. Intl. Fiscal Docn. 12 (2002), Journals IBFD; Avi-Yonah & Clausing, *supra* n. 44; and A. Ting, *Multilateral Formulary Apportionment Model: A Reality Check*, 25 Austrl. Tax Forum 1, pp. 95-136 (2010).
89. M. Deveraux & R. de la Feria, *Designing and Implementing a Destination-Based Corporate Tax*, Working Paper 14/07 (Oxford U. Ctr. Bus. Taxn. 2014). This was not, however, the first time that academics have argued for such a regime. *See*, inter alia, R.S. Avi-Yonah, *Globalization, Tax Competition and the Fiscal Crisis of the Welfare State*, 113 Harvard L. Rev. 7 (2000) and J. Mirrlees et al. eds., *Dimensions of Tax Design: the Mirrlees Review* (Oxford U. Press 2010).

ication of the complications and risks they generate (*see* section 3.3.). For its part, the DBCT would also render transfer pricing regulations irrelevant.

Secondly, taxation would no longer arise wherever a company is deemed to be located for tax purposes. This means that the geographical position of the company (i.e. the state in which it is tax resident or where its PE is located) would thus cease to determine which state should be entitled to tax the company's profits. This should be welcomed as good news, considering the increasing irrelevance and inappropriateness of the notions of corporate tax residence and PE and the subsequent disadvantages of making taxation heavily dependent on them. As stated in section 3.4., corporate residence tests are generally meaningless, easy to manipulate and do not ensure a sufficiently genuine connection between the taxpayer and the state which claims to be the residence state, particularly in the case of formal tests. For its part, the PE concept has not kept pace with the new business scenario and has thus become instrumental in ensuring avoidance of source-based taxation rather than the opposite.[90]

Finally, and most importantly, both regimes would contribute to accomplishing the BEPS mantra (*see* section 1.). Taxation would arise wherever assets are kept, employees work, sales are conducted (as in the CCCTB) or where the final customer resides (as with the DBCT), so, to the extent that it is understood that these are valid indicators of where value is generated, it can be concluded that the outcomes of both regimes would be better aligned with the ultimate policy objectives expressed in the OECD/G20 BEPS initiative. Incidentally, by making taxation dependent on these factors, tax planning opportunities would tend to diminish, as they are generally less susceptible to manipulations.

4. Conclusions

The measures resulting from the BEPS Action Plan will undoubtedly contribute to achieving the two objectives set in the BEPS Report: the prevention of double non-taxation and the alignment of taxing rights with the presence of an economic activity. However, doubt will remain as to whether more ambitious approaches could and should have been taken. Would they have contributed to achieving these objectives more satisfactorily and effectively? Would political agreement on such approaches have been reached? While the answer to the first two questions is likely to be positive, the answer to the third one is doubtful. Now that the creative phase of the OECD/G20 BEPS initiative is almost over and the implementation phase is underway, it is time for academics and international organizations, such as the United Nations and European Union, to lead the way forward. The question that the author leaves readers with is, therefore, this: is it possible to abandon prejudices and put forward brave solutions that are not only feasible but also likely to result in political agreement?

90. Skaar, *supra* n. 69, at p. 559.

