INTERNATIONAL TAX LAW IN THE POST-BEPS WORLD

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I. Introduction

The perception of taxpayers in many countries is that the system is unfair or broken – this is worsened by the global financial crisis and heightened by media scrutiny into the taxation of MNEs. The existence of tax havens is often thought to have contributed to the financial crisis and has had an impact on the fiscal sustainability of countries, although there is no concrete evidence to this effect. All the above was important ammunition for the Base Erosion and Profit Shifting (BEPS) project, though still, none expected the unprecedented standard-setting effort in such a challenging area, which set the ground for multilateralism to blossom.

There were a number of factors that led to this. First, the financial crisis and public austerity that ensued elevated international tax issues onto the global political agenda.[1] This helped move international tax discussions beyond technical OECD committees and into the limelight of the G20. The G20 umbrella certainly helped expedite the process, as it did with the development of international financial law. "In two years, BEPS produced agreement on issues that technical experts had not even been prepared to broach for decades."[2]

Realistic objectives were also a contributing factor. From the launch of the BEPS project, the OECD declared that it would not carry out a holistic review of the international tax regime. It was stated in the Action Plan that the project was not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income. What it sought to do was to restore both source and residence taxation where cross-border income would otherwise go untaxed or would be taxed at very low rates. For most of the deliverables, the OECD did not make drastic recommendations but was rather limited to realistic compromises that had more chances of success and consensus.

This paper will review themes arising from the BEPS project and some reverberations from the final deliverables, also in light of post-BEPS developments. It will question whether the final deliverables address the problems identified at inception and the possible impact of this on the development of international tax law. Developments in the European Union in this area will also be analysed. This paper covers developments up to the 25 May, 2016.

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1 Itai Grinberg & Joost Pauwelyn, "*The Emergence of a New International Tax Regime: The OECD's Package on Base Erosion and Profit Shifting (BEPS)*", ASIL, Issue: 24, vol. 19
2 *Ibid*.

II. The OECD/G20's Base Erosion and Profit Shifting Project

Backed by both G8 and G20 countries,[3] the OECD report *Addressing Base Erosion and Profit Shifting*[4] was released on 12 February, 2013. BEPS was described as "tax planning strategies that exploit gaps and mismatches in tax rules to make profits 'disappear' for tax purposes or to shift profits to locations where there is little or no real activity but the taxes are low resulting in little or no overall corporate tax being paid".[5]

At a ministerial council meeting in Paris on the 29-30 May 2013, the OECD adopted a declaration on BEPS.[6] It reiterated that BEPS "constitutes a serious risk to tax revenues, tax sovereignty and the trust in the integrity of tax systems of all countries that may have a negative impact on investment, services and competition, and thus on growth and employment globally".[7] The declaration emphasized the need for governments to work together to develop methods of addressing asymmetries in domestic and international tax laws that can result in double non-taxation or very low effective taxation. There was a pressing need to address BEPS and to work towards a level playing field in this area.[8]

In July 2013, the OECD launched the BEPS Action Plan, in which it identified specific courses of action to be taken.[9] The OECD recognised that fundamental changes were needed to effectively prevent double non-taxation, but also cases of no or low taxation "associated with practices that artificially segregate taxable income from the activities that generate it".[10] A realignment of taxation and substance was needed, as international tax standards may not have kept pace with changing business models and technological developments.[11] While the Action Plan was not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income, it sought to restore both source and residence taxation where cross-border income would otherwise go untaxed or would be taxed at very low rates.[12]

The need for consensus and multilateralism was emphasised. "[I]f the Action Plan fails to develop effective solutions in a timely manner, some countries may be

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3 See references to statements of heads of States in Martijn Nouwen, *"The Gathering Momentum of International and Supranational Action against Aggressive Tax Planning and Harmful Tax Competition: The State of Play of Recent Work of the OECD and the European Union",* 53 [2013] 10 European Taxation 491-496

4 OECD (2013), *Addressing Base Erosion and Profit Shifting,* OECD Publishing

5 Available on: http://www.oecd.org/ctp/beps-frequentlyaskedquestions.htm

6 See OECD, *Declaration on Base Erosion and Profit Shifting Adopted on 29 May 2013*. Available on: http://www.oecd.org/mcm/C-MIN%282013%2922-FINAL-ENG.pdf

7 *Ibid*, p.2

8 *Ibid*, p.2

9 OECD (2013), *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing. Available on: http://www.oecd.org/ctp/BEPSActionPlan.pdf

10 *Ibid*, p.13

11 *Ibid,* p.13.

12 *Ibid*, p.11

persuaded to take unilateral action for protecting their tax base, resulting in avoidable uncertainty and unrelieved double taxation."[13]

The BEPS Action Plan, which was fully endorsed by the G20, outlined 15 actions that need to be taken across a range of areas. Fundamental changes to the international tax architecture and the current source/residence dichotomy were ruled out. The technical work was undertaken by the Committee on Fiscal Affairs (CFA) through a number of its working parties and other subsidiary bodies.[14] The Action Plan was broadly concerned with reform in the following categories.

The first category related to rules on tax base allocation and, to an extent, the application of the source/residence doctrines to some modern day transactions. Aligning value creation with taxation was indisputably the leitmotif. Topics such as taxation of digital economy,[15] the avoidance of the PE status,[16] transfer pricing of intangibles and other high risk transactions[17] would appear to fall under this category.

The second category related to anti-abuse rules tackling base erosion and preventing double non-taxation. These would include rules on hybrids,[18] CFC rules,[19] thin capitalisation rules,[20] the countering of harmful tax practices [21] and anti-treaty-shopping rules.[22]

The third category dealt with procedural reforms. One set of suggestions was to devise rules on country by country reporting for transfer pricing documentation.[23] The Action Plan also suggested rules to collect and analyse data and counteractions.[24] Rules demanding disclosure of aggressive tax planning arrangements[25] were also to be developed.

Suggestions to make dispute resolution more effective[26] and to develop multilateral instruments[27] could be viewed as part of the procedural reforms, or as comprising a fourth category on promoting (more effective) multilateralism. The proposals under

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13 *Ibid*. On this point, see also David D. Stewart, *"Unilateral Changes in Anticipation of OECD BEPS Project Risk Fragmenting Tax Rules"*, 2013 WTD 226-2 (November 22, 2013)

14 These are Working Parties 1, 2, 6 and 11, as well as the Forum on Harmful Tax Practices and the Task Force on Digital Economy. Working Party 1 *(Tax Conventions and Related Questions*), in relation to part of action 2, action 6, action 7 and action 14. Working Party 2 *(Tax Policy Analysis and Tax Statistics)*, in relation to action 11. Working Party 6 in relation to part of action 4, actions 8-10 and 13. Working Party 11 (Aggressive Tax Planning), in relation to part of action 2, action 3, part of action 4 and action 12. The Forum on Harmful Tax Practices, in relation to action 5 and the Task Force on Digital Economy in relation action 1. See http://www.oecd.org/tax/beps-about.htm

15 Action 1

16 Action 7

17 Actions 8-10

18 Action 2

19 Action 3

20 Action 4

21 Action 5

22 Action 6

23 Action 13

24 Action 11

25 Action 12

26 Action 14

27 Action 15

the action item on harmful tax practices could also be perceived as falling under this category.[28]

Arguably, most of the action items, especially those under the first two categories (i.e. tax base allocation rules and anti-abuse rules), were not really new.[29] In some of the BEPS deliverables the OECD refined its previous work but in a few instances it departed from it.

Following an intensive two year period in which the OECD produced drafts for all the action items, consulted various stakeholders in meetings not just in Paris but also internationally and revised drafts, the final reports came out on 5 October 2015. Upon the release of this highly anticipated (and surprisingly on schedule) package of final reports, Pascal Saint-Amans, the director of the OECD's Centre for Tax Policy and Administration (CTPA), announced that the reports represented a change in paradigm that would help eliminate double non-taxation.[30] The reports were also a strong indication of the underlying agreement among countries to fix the international tax system. The BEPS Package "represents the first substantial—and overdue—renovation of the international tax standards in almost a century."[31] Along with the final reports, the OECD published an explanatory statement explaining the political commitment of OECD and G20 countries to the BEPS project package and its consistent implementation.

The explanatory statement set out the *minimum standards* in four areas that countries agreed to. These minimum standards were the prevention of harmful tax practices, in particular in the area of intellectual property and through the automatic exchange of information on tax rulings (action 5), dealing with treaty shopping to reduce the use of conduit companies to channel investments (action 6), country-by-country reporting to provide tax administrations with a global picture of the operations of multinationals (action 13), and improving dispute resolution, to ensure that the fight against double non-taxation does not result in double taxation (action 14).

Other than the agreed minimum standards, the BEPS project provided reinforced international standards, such as the revised OECD Transfer Pricing Guidelines (Actions 8-10)[32] and the revised OECD Model Tax Convention (including Action 7 on the PE status). These recommended measures were *standards* that all countries had committed to implementing swiftly. There were also recommendations in the form of common approaches and *best practices* for domestic law, such as the ones on hybrid mismatch arrangements (Action 2), controlled foreign company rules (Action 3), interest limitations (Action 4) and disclosure of aggressive tax planning (Action 12).

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28 Action 5

29 Regarding the overlap with previous initiatives and reports, see, *inter alios,* Yariv Brauner, *"What the BEPS?",* 16 [2014] Florida Tax Review 55; Hugh J. Ault & Wolfgang Schön & Stephen E. Shay, *"Base Erosion and Profit Shifting: A Roadmap for Reform",* 68 [2014 6/7 Bulletin for International Taxation 275-279; Nathan Boidman & Michael N. Kandev, *"BEPS: The OECD Discovers America?",* Tax Notes Int'l, Dec. 16, 2013, p. 1017; 72 Tax Notes Int'l 1017 (Dec. 16, 2013) etc.

30 See Stephanie Soong Johnston, *OECD Publishes Final BEPS Package Ahead of G-20 Meeting,* Tax Notes Int'l, Oct. 12, 2015, p. 103; 80 Tax Notes Int'l 103 (Oct. 12, 2015)

31 OECD/G20 BEPS Project, Explanatory Statement, para 8 (2015)

32 The OECD has not yet issued a revised version of the OECD Transfer Pricing Guidelines 2010, however for the UK the Finance (No. 2) Bill , clause 71 will add the revisions in Actions 8-9-10 to TIOPA s. 164(4)

There were also analytical reports on the tax challenges of the digital economy (Action 1), data and analysis with respect to BEPS (Action 11) and the multilateral instrument for implementing treaty based recommendations (Action 15).

The final package was approved at the G20 finance ministers' meeting in Lima, Peru October 8 and the November 15-16 summit in Antalya, Turkey.

What seems to be emerging from the above categorisation of the OECD's proposals, is that in the context of the BEPS project, the OECD's focus appears to be turning into the development of a monitoring mechanism, whilst at the same time ensuring compliance with minimum standards. The OECD is hoping that the BEPS recommendations will usher in a return to a common-sense approach to taxing multinationals, and companies would no longer structure their tax affairs without the underlying economic substance being aligned.

The next part of this paper will review the OECD recommendations under each Action item of the BEPS Action Plan.

III. The BEPS Action Items

1. Addressing the tax challenges of the Digital Economy: Action 1

Action 1 deals with the challenges that the digital economy poses for the application of existing international tax rules and the possible solutions. Some of the existing problems and the scope of the work to be undertaken were described in Action 1 of the BEPS Action Plan.

"Identify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties, taking a holistic approach and considering both direct and indirect taxation. Issues to be examined include, but are not limited to, the ability of a company to have a significant digital presence in the economy of another country without being liable to taxation due to the lack of nexus under current international rules, the attribution of value created from the generation of marketable location-relevant data through the use of digital products and services, the characterisation of income derived from new business models s, the application of related source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services. Such work will require a thorough analysis of the various business models in this sector".[33]

The overall concern in this area is the absence of base creation rather than the existence of base erosion. This is not a new area of concern. In the late 1990s, the

[33] BEPS Action Plan, pp.14-15

digital economy, then in its embryonic form referred to as e-commerce, was considered by the OECD. The OECD agreed to the Ottawa Taxation Framework Conditions,[34] whereby "taxation principles which guide governments in relation to conventional commerce should also guide them in relation to electronic commerce".[35] However, the rapid evolution of information and communication technologies has led to renewed attempts to address the taxation of digital economy.

The discussion drafts[36] developed by the Task Force on Digital Economy (prior to the release of the Final Report on Action 1) revisited the key features of the "new" business models in the digital economy, how these features may exacerbate BEPS risks and how these issues should be addressed. It was noted that BEPS concerns were raised by situations in which taxable income could be artificially segregated from the activities that generated it or an inappropriately low amount of tax (or no tax) is collected on remote digital supplies to exempt businesses or multi-location enterprises that are engaged in exempt activities. Although the nature of strategies used to achieve BEPS in digital businesses was similar to that of traditional businesses, it was conceded that some of the key characteristics of the digital economy exacerbated risks of BEPS, and examples of structures were given. Overall, the previous discussion drafts and the Final Report were largely descriptive of the current situation and did not make any specific recommendations.

In the Final Report, the OECD continued to acknowledge that it would be impossible to ring-fence the digital economy for the purposes of creating separate tax rules "[b]ecause the digital economy is increasingly becoming the economy itself".[37] Attempting to isolate the digital economy "would inevitably require arbitrary lines to be drawn between what is digital and what is not".[38] Furthermore, as the digital economy is in a continuous state of evolution, "possible future developments need to be monitored to evaluate their impact on tax systems".[39]

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34 OECD, *Electronic Commerce: Taxation Framework Conditions - A Report by the Committee on Fiscal Affairs*, as presented to Ministers at the OECD Ministerial Conference, "A Borderless World: Realising the Potential of Electronic Commerce" on 8 October 1998.
Available on: http://www.oecd.org/tax/consumption/1923256.pdf

35 OECD, *Electronic Commerce: Taxation Framework Conditions*, para 4. The broad taxation principles which should apply to electronic commerce were the following: neutrality, efficiency, certainty and simplicity, effectiveness and fairness and lastly, flexibility. More work was to be done in a post-Ottawa agenda and process. Christiana HJI Panayi, *Advanced Issues in International and European Tax Law* (Hart Publishing, 2015), chapter 2.

36 Public Discussion Draft, *BEPS Action 1: Address the Tax Challenges of the Digital Economy*, 24 March 2014 – 14 April 2014 (henceforth, the Digital Economy Discussion Draft). Available on: http://www.oecd.org/ctp/tax-challenges-digital-economy-discussion-draft-march-2014.pdf. A revised discussion draft was published in September 2014. See OECD, *Addressing the Tax Challenges of the Digital Economy, OECD Publishing* (henceforth, Digital Economy Revised Discussion Draft). Available on: http://www.keepeek.com/Digital-Asset-Management/oecd/taxation/addressing-the-tax-challenges-of-the-digital-economy_9789264218789-en#page3

37 OECD (2015), Addressing the Tax Challenges of the Digital Economy, Action 1 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p.12. Available on: http://www.oecd-ilibrary.org/docserver/download/2315281e.pdf?expires=1463923623&id=id&accname=guest&checksum=97DF377C062AF3ECE7211A4A33BF3042

38 *Ibid*.

39 *Ibid*.

As a piecemeal solution, the Task Force on Digital Economy agreed to change the list of exceptions to the permanent establishment definition under article 5 of the OECD Model by restricting it to "preparatory or auxiliary activities" - a measure subsequently adopted under Action 7,[40] that will likely be implemented across the existing tax treaty network through the multilateral instrument developed under action 15.[41]

The Final Report largely followed the progression of the discussion drafts. It noted that recommended measures in other areas of the BEPS project, such as those related to transfer pricing guidance (action 8), designing effective CFC rules (action 3), and applying a substantial activity requirement with a nexus approach to intellectual property regimes (action 5), 'will substantially address the BEPS issues exacerbated by the digital economy' at the ultimate parent company jurisdiction and market jurisdiction and help end the 'stateless income' phenomenon.[42]

The report also recommended that countries apply the OECD's international VAT/GST guidelines for the collection of VAT on cross-border business-to-consumer supplies and services and intangibles, and consider implementing collection mechanisms described within those guidelines.[43] Working Party 9 had already been working on the issue for its international VAT/GST guidelines and would continue to work on packages to help coordinate countries' implementation of the international VAT/GST guidelines. Effectively, a shift to collecting tax in the jurisdiction of consumption (i.e. the country of residence of the consumer) was recommended, even though taxing such supplies in the country of residence of the consumer was likely to place a large compliance burden on vendors in the global digital economy and potentially increase the cost to consumers.[44]

As the digital economy continued developing, it was promised that work would also continue in the post-BEPS world. Working Party 1 of the Committee on Fiscal Affairs would also clarify the characterization of certain payments under new business models, such as cloud computing payments, under current tax treaty rules. Future work would be based on a mandate that will be developed in 2016 to design a monitoring process.

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40 See below Part III.7 below

41 The Final Report also approved the introduction of the 'anti-fragmentation rule'. See below, section Part III.7 below.

42 In the Final Report, the task-force did not recommend any of the options it had previously considered for taxing income from sales of digital goods and services by foreign suppliers lacking a PE under current rules. See HJI Panayi (2015), *fn*.35, chapter 2

43 The CFA had been working on the International VAT/GST Guidelines to address issues of double taxation and unintended non-taxation resulting from inconsistencies in the application of VAT in international trade. The first three chapters of these Guidelines were approved in January 2014 and were endorsed as a global standard at the second meeting of the OECD Global Forum on VAT on 17-18 April 2014 in Tokyo. On 18 December, the OECD published a joint discussion draft dealing with two new elements to be included in these Guidelines, relating to the place of taxation of business-to-consumer supplies of services and intangibles and provisions to support the application of the Guidelines in practice. Discussion Drafts for Public Consultation, *International VAT/GST - Guidelines on Place of Taxation for Business-To-Consumer Supplies of Services and Intangibles Provisions – Provisions on Supporting the Guidelines in Practice* (18 December 2014 -20 February 2015).

44 For B2B this generally means a recharge or self-assessment. For B2C remote suppliers of digital services will need to register and account for VAT in the country of residence of their customer.

Whilst obviously the recommendations should be read in the context of the other recommendations under the BEPS Action Plan, arguably, the undertone of these recommendations is one of slight indecisiveness and deference to the future. Effectively, the report encourages countries to tackle digital BEPS challenges unilaterally with some very 'soft' guidance – most of it still forthcoming - from the OECD. This is likely to lead to global uncertainty and inconsistency. A cursory review of the recommendations under the Final Report on Action 1 suggests that it has not adequately addressed the tax challenges arising from the digital economy.

2. Neutralising the Effects of Hybrid Mismatch Arrangements: Action 2

Under Action 2, the OECD has called for the development of instruments to neutralise the effects of hybrid mismatch arrangements.[45] Producing such rules was expected to be very challenging. Getting an agreement on a common set of rules for the classification and taxation of financial instruments and entities was a herculean task. The OECD opted for coordination – as comprehensive as is possible, with the rules applying automatically to neutralise the mismatch, while still being administrable and avoiding double taxation.[46] Following the basic design of hybrid rules from earlier drafts,[47] the Final Report on Action 2 recommended changes to domestic law (Part I) and to the OECD Model (Part II).[48]

Part I set out recommendations for rules to address tax mismatches arising in respect of payments made under a hybrid financial instrument or payments made to or by a hybrid entity. It also recommended rules to address indirect mismatches that arise when the effects of a hybrid mismatch arrangement are imported into a third jurisdiction. The recommendations take the form of linking rules that align the tax treatment of an instrument or entity with the tax treatment in the counterparty

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45 Action 2 of the BEPS Action Plan reads as follows: *"Develop model treaty provisions and recommendations regarding the design of domestic rules to neutralise the effect (e.g. double non-taxation, double deduction, long-term deferral) of hybrid instruments and entities. This may include: (i) changes to the OECD Model Tax Convention to ensure that hybrid instruments and entities (as well as dual resident entities) are not used to obtain the benefits of treaties unduly; (ii) domestic law provisions that prevent exemption or non-recognition for payments that are deductible by the payor; (iii) domestic law provisions that deny a deduction for a payment that is not includible in income by the recipient (and is not subject to taxation under controlled foreign company (CFC) or similar rules); (iv) domestic law provisions that deny a deduction for a payment that is also deductible in another jurisdiction; and (v) where necessary, guidance on co-ordination or tie breaker rules if more than one country seeks to apply such rules to a transaction or structure. Special attention should be given to the interaction between possible changes to domestic law and the provisions of the OECD Model Tax Convention. This work will be co-ordinated with the work on interest expense deduction limitations, the work on CFC rules, and the work on treaty shopping."*

46 John Peterson, "*Action 2: Neutralising the effect of hybrid mismatch arrangements*", International Tax Review. 1/4/2016, p.3

47 OECD, *BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (Recommendations for Domestic Laws) 19 March 2014-2 May 2014*; OECD, *BEPS Action 2: Neutralise the Effects of Hybrid Mismatch Arrangements (Treaty Issues) 19 March 2014 – 2 May 2014*

48 OECD (2015), *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 - 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available on: http://dx.doi.org/10.1787/9789264241138-en

jurisdiction. Apart from this linking, the recommended rules do not seem to disturb the commercial outcomes. The rules apply automatically and there is a rule order in the form of a primary rule and a secondary/defensive rule. This prevents more than one country applying the rule to the same arrangement and tries to ensure that the primary response to the mismatch would always be in the jurisdiction that was best placed to make the adjustment. It also avoids double taxation.

The recommended primary rule was that countries should deny a taxpayer's deduction for a payment to the extent that this payment is not included in the taxable income of the recipient in the counterparty jurisdiction or it is also deductible in the counterparty jurisdiction. If the primary rule was not applied, then the counterparty jurisdiction could generally apply a defensive rule, requiring the deductible payment to be included in income or denying the duplicate deduction depending on the nature of the mismatch. The importance of coordination in the implementation and application of the hybrid mismatch rules was emphasised. Detailed parameters on the scope of the rules were set out to ensure that the rules are effective and to minimise compliance/administration costs for taxpayers and tax administrations. To this end, the Final Report on Action 2 set out a common set of design principles and defined terms to ensure consistency in the application of the rules.[49]

Part II addressed the use of hybrids to obtain unduly tax treaty benefits. Recommendations for amendments to the OECD Model were made, in order to address the following two problems: the use of dual resident entities and the use of transparent entities to obtain the benefits of treaties unduly.

From this brief overview of the Action 2 proposals, it would seem that it is not necessary for every country to introduce hybrid mismatch rules for them to be effective. It would seem more important to the successful operation of the rules to have a common approach so that countries' hybrid rules are consistent with each other both in their operation and scope.

However, the OECD's deliberate attempts to address the problem of hybrids through a series of unilateral domestic rules rather than a supra-national instrument had been criticised when the earlier drafts were released.[50] As a result of the proposals, domestic tax law are likely to become much more contingent and structurally dependent on the policies and practices of other governments, thus, to an extent, surrendering some of their tax sovereignty. It has been claimed that so far, the deliverables in Action 2 and the design principles therein are "agnostic as to who should be collecting tax from situations involving inconsistent government choices".[51] Overall, there is a significant departure from the BEPS mantra of taxing income where it is earned.

As is explained in Part 4, in the European Union, an attempt was made to address hybrids through an amendment to the Parent-Subsidiary Directive. Furthermore, the recently proposed Anti-Tax Avoidance Directive contains a clause on hybrid

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49 *Ibid*, pp.11-12
50 See analysis by Graeme S. Cooper, *"Some Thoughts on the OECD's Recommendations on Hybrid Mismatches",* 69 [2015] 6/7 Bulletin for International Taxation 334-349
51 *Ibid.*

mismatches,[52] which largely gives effect to guidance issued previously by the EU Code of Conduct Group on Business Taxation[53] and Action 2 BEPS proposals.

3. Strengthen CFC rules: Action 3

CFC rules aim to address profit shifting to foreign low taxed subsidiaries, leading to tax base stripping and often long-term deferral of taxation. Although many countries have CFC rules, these may not have kept pace with changes in the international business environment. In fact, ineffective CFC rules were widely thought to be a key element contributing to BEPS.[54]

Under Action 3 of the BEPS Action Plan, the OECD was to develop recommendations regarding the design of controlled foreign company rules. The discussion draft[55] and the Final Report[56] on Action 3 set out recommendations for the design of effective CFC rules.

As under the earlier discussion draft, the recommendations in the Final Report on Action 3 were in the form of "building blocks" – building blocks that are necessary for the design of effective CFC rules. These recommendations were not minimum standards,[57] but were designed to ensure that jurisdictions that choose to implement them will have rules that effectively prevent taxpayers from shifting income into foreign subsidiaries.

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52 See proposed Article 10 which reads as follows: "Where two Member States give a different legal characterisation to the same taxpayer (hybrid entity), including its permanent establishments in one or more Member State, and this leads to either a situation where a deduction of the same payment, expenses or losses occurs both in the Member State in which the payment has its source, the expenses are incurred or the losses are suffered and in another Member State or a situation where there is a deduction of a payment in the Member State in which the payment has its source without a corresponding inclusion of the same payment in the other Member State, the legal characterisation given to the hybrid entity by the Member State in which the payment has its source, the expenses are incurred or the losses are suffered shall be followed by the other Member State.
Where two Member States give a different legal characterisation to the same payment (hybrid instrument) and this leads to a situation where there is a deduction in the Member State in which the payment has its source without a corresponding inclusion of the same payment in the other Member State, the legal characterisation given to the hybrid instrument by the Member State in which the payment has its source shall be followed by the other Member State."

53 Code of Conduct (Business Taxation) – Report to Council, 16553/14, FISC 225, 11.12.2014; Code of Conduct (Business Taxation) – Report to Council, 9620/15, FISC 60, 11.6.2015.

54 Kate Ramm, "*Action 3: Designing effective controlled foreign company rules*"**,** International Tax Review, 1/4/2016, p2-2. 1p.

55 OECD, *Public Discussion Draft, BEPS Action 3: Strengthening CFC Rules* (henceforth, CFC Discussion Draft). Available on: http://www.oecd.org/ctp/aggressive/discussion-draft-beps-action-3-strengthening-CFC-rules.pdf

56 OECD (2015), Designing Effective Controlled Foreign Company Rules, Action 3 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241152-en

57 See also Part II above.

The discussion was largely a discussion of alternative approaches and all the alternatives were expressly optional. This approach allows countries without CFC rules to identify the key elements for effective rules and allows other countries to modify their rules in line with the recommendations. The various options reflect a deep lack of consensus among stakeholders. The OECD recognises the need for flexibility, as the design of CFC rules reflect differing policy objectives, in particular depending on whether they have a worldwide or territorial tax system or whether they are EU members. Although policy considerations underpinning CFC policies might differ, there are some shared policy considerations.

The six building blocks included the definition of a CFC and of CFC income and the attribution of CFC income. The building blocks generally encompassed the elements included in existing CFC rules and reflected best practices.

The definition of CFC income was one of the key building blocks, for which there were clearly differing views. The Final Report set out recommendations on how to determine when shareholders have sufficient influence over a foreign company for that company to be a CFC. It also provided recommendations on how non-corporate entities and their income should be brought within CFC rules. The definition of a CFC considered the entities that should be included within CFC rules and suggested inclusion of transparent entities and permanent establishments where they raise the same BEPS concerns as foreign subsidiaries. It also set out a form of anti-hybrid rule to prevent avoidance of CFC rules. There were proposals as to when residents can be regarded as having sufficient influence for an entity to be considered to be 'controlled'. A non-exhaustive list of approaches (e.g. substance and excess profits analysis) was included to accommodate those differing views.

CFC exemptions and threshold requirements could be used to limit the scope of CFC rules and exclude entities that posed little BEPS risk. The report specifically recommended that CFC rules would only be applied to foreign companies that were subject to an effective tax rate that was meaningfully lower than that applied in the parent company jurisdiction.

Regarding the definition of income, rather than focusing on existing practices, the Final Report provided flexibility and set out a non-exhaustive list of approaches that countries could chose to adopt. One such approach was a substantial activity test based on the nexus approach that was developed in the context of the work on intellectual property regimes under Action 5.

As for the computation of income, it was recommended that the calculation of the income to be attributed ought to be undertaken using the rules of the parent jurisdiction shareholders. The Final Report also examined the use of losses and recommended that CFC losses should only be offset against profits of the same CFC or other CFCs in the same jurisdiction.

There were recommendations on attribution of income to residents with an interest in the CFC. The report recommended that, when possible, the attribution threshold should be tied to the control threshold and that the amount of income to be attributed should be calculated by reference to the proportionate ownership or influence.

The prevention and elimination of double taxation arising from the application of CFC rules was one of the fundamental policy issues to be considered when designing such rules. The report emphasised the importance of this building block and recommended that countries allow credit for foreign tax actually paid in respect of a CFC, including any tax on income attributed to an intermediate parent company. It also recommended that countries consider relief from double taxation on dividends on, and gains arising from the disposal of, CFC shares where the income of the CFC had previously been subject to taxation under a CFC regime.

On the basis of these guidelines, countries were expected to find a balance between having effective rules that do not lead to double taxation and not unduly increasing the administrative burden and compliance costs for taxpayers.

In the CFC Discussion Draft and the Final Report, the obligations for EU Member States were also considered. It was acknowledged that whilst recommendations developed under Action 3 needed to be broad enough to be effective in combatting BEPS they also had to be adaptable, where necessary, to enable Member States to comply with EU law.[58] The CFC Discussion Draft referred to the *Cadbury Schweppes* case[59] and the wholly artificial arrangements test, as the litmus test.[60] It was also argued that on the basis of the *Thin Cap GLO* case,[61] a CFC rule in a Member State that targeted income earned by a CFC that was not itself wholly artificial may be justified so long as the transaction giving rise to the income was at least partly artificial. Reference was also made to the *SGI*[62] and *OyAA*[63] cases as supporting that a CFC regime may not be limited to wholly artificial arrangements, if the regime explicitly ensured a balanced allocation of taxing power. This position is repeated in the Final Report.[64]

It was also noted that under EU law, a CFC rule would only be found inconsistent with the freedom of establishment if the rule itself discriminated against non-residents. Therefore, if a CFC rule treated domestic subsidiaries the same as cross-border subsidiaries, there would be no discrimination. Of course, CFC regimes tend to apply to non-resident subsidiaries. There was acknowledgement of the concern that non-EU-based multinational groups could be put at a competitive disadvantage compared to groups within the EU if the latter were subject to less vigorous CFC rules under EU law.

The author has criticised the OECD's interpretation of the case law of the Court of Justice as suggesting that, on the basis of the *Thin Cap Litigation* case,[65] a CFC regime may not be limited to wholly artificial arrangements.[66] The OECD had argued in the CFC Discussion Draft and the Final Report that on the basis of the *Thin Cap*

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58 See Final Report on Action 3, para 19, p.17
59 Case C-196/04 *Cadbury Schweppes and Cadbury Schweppes Overseas* [2006] ECR I-7995
60 CFC Discussion Draft, para 14
61 Case C-524/04 *Test Claimants in Thin Cap Group Litigation Order* [2007] ECR I-2107
62 Case C-311/08 *Société de Gestion Industrielle (SGI) v. Belgian State* [2010] ECR I-0487
63 Case C-231/05 *Oy AA* [2007] *ECR* I-6373
64 Final Report on Action 3, paras 20-22
65 *Thin Cap GLO*, *fn.* 61, above.
66 See HJI Panayi (2015), *fn.*35, chapter 6. Also, see Christiana HJI Panayi, *"The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU Law"*, 70 [2016] 1/2 Bulletin for International Taxation pp.95-112.

Litigation case, a CFC rule in a Member State that targeted income earned by a CFC that was not itself wholly artificial may be justified so long as the transaction giving rise to the income is at least partly artificial.67 However, the OECD's reliance on the language of 'partly artificial arrangement' is very suspicious. First, *Cadbury Schweppes* remains the main, directly relevant authority for CFC rules and not the *Thin Cap GLO* case, which dealt with rules restricting interest deductibility.68 Secondly, the analysis in the CFC Discussion Draft and the Final Report ignore subsequent cases where the wholly artificial arrangements test was emphatically reiterated,69 particularly in the context of CFC regimes.70

Thirdly, while there was mention once in the *Thin Cap GLO* judgment of 'the transaction in question representing, in whole or in part, a purely artificial arrangement',71 not much importance was placed on this point by the Court of Justice – or by commentators since then. The wholly artificial arrangements test of *Cadbury Schweppes* was repeated throughout the judgment as being the guiding authority. Perhaps references to a transaction being in part a purely artificial arrangement were relevant to the specific transaction in question: an excessive loan interest payment. Part of this payment was at arm's length, part of this was non-arm's length. Technically, the impact of the thin cap legislation was on the non-arm's length amount. This is arguably why the Court of Justice referred to the transaction being in part a purely artificial arrangement. But the (excessive) interest payment does not arise out of nowhere – it is part of a loan agreement. While to an extent the entirety of the loan agreement could be seen as an artificial arrangement, technically, it was only a part of it – the non-arm's length part of the interest payment – that was to be re-characterised under the relevant anti-abuse legislation.

Extrapolating a new interpretation of the artificial arrangements test from a brief passing remark in a relatively old judgment is clearly aimed at eroding the importance of the *Cadbury Schweppes* test. Moreover, it seems slightly disingenuous for the OECD to argue that the relevant authority in a CFC context is a case on thin capitalisation rather than the case on CFC regimes which has hitherto been considered as the main authority. For any proposals made under Action 3 to be compatible with EU law, they should follow the established *Cadbury Schweppes* test and not the interpretation of it suggested under the CFC Discussion Draft. It is rather unfortunate that the OECD reiterated this reasoning in the Final Report on Action 3.

As expected, the outcome of Action 3 of the BEPS project was a menu of approaches, or best practices suggestions, or both. Certainly, the lack of consensus on a uniform approach suggests fundamental disagreements and a deep political split among OECD countries as to how strict the CFC rules should be. The lack of consensus on the CFC rules can also be attributed in part to countries' self-interest and a misconception that

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67 CFC Discussion Draft, p.11, para 14; Final Report on Action 3, p.18

68 See chapter 8 in Christiana HJI Panayi, *European Union Corporate Tax Law* (Cambridge University Press, 2013), where it is explained how there have been slight variations to the *Cadbury Schweppes* test in different areas of the anti-abuse case law, especially for transfer pricing.

69 See , Case C-282/12 *Itelcar v Fazenda Publica* [2013] ECR I-0000 and Case C-112/14 *Commission v UK,* ECLI:EU:C:2014:2369

70 See, for example, Case C-201/05 *Test Claimants in the CFC and Dividend Group Litigation v Commissioners of Inland Revenue (CFC GLO)* [2008] ECR I-2875.

71 *Thin Cap GLO*, para 81

transfer pricing rules can do the job.[72] Furthermore, countries may choose not to have CFC rules so as to attract companies and capital. The current approach under Action 3 seems to give a competitive advantage to companies in countries with more relaxed regimes and as a corollary could generate more tax competition which could exacerbate rather than mitigate base erosion and profit shifting.

There have also been criticisms in that, notwithstanding the substantial overlap with the other BEPS actions, the lack of consensus among countries in the CFC Discussion Draft raises the question of what role CFC rules should play in the BEPS project altogether and whether they might in fact be unnecessary in addressing base erosion and profit shifting.[73] The BEPS Monitoring Group argued that post-BEPS CFC rules must be set at a high standard and be coordinated because "a weak standard which is left to states to implement would be counter-productive, as it would encourage source states to reduce their tax rates, and hence worsen the race to the bottom in corporate tax".[74] Strong CFC rules could give the BEPS project a better chance of success and a better chance of ensuring that MNEs are taxed where economic activities take place and value is created. Weak rules would mean failure.

The adoption of a full inclusion approach was recommended by the BEPS Monitoring Group, under which the home country would tax all CFC income, with a credit for foreign taxes paid.[75] An alternative approach was a substance test based on the proportion of profit to employees, determined by payroll costs. It would apply if the effective tax rate in the CFC's country of residence was below 95% of that of the home country. The preferred response was to adopt a more explicitly unitary approach to MNEs, "for example by systematizing and regularizing the profit split method with defined concrete allocation factors and weightings for all commonly used business models".[76] By apportioning profits according to appropriate measures of real economic activity, this would leave countries free to set their corporate tax rates, balancing encouragement of investment in real activities with optimizing tax revenues.[77]

Whilst the expectation for an international unitary approach to be applied to MNEs is currently unrealistic, in the EU, the Common Consolidated Corporate Tax Base (CCCTB)[78] proposal *does* contain CFC rules in a unitary context. However, these CFC rules would only apply to subsidiaries resident in third countries. To the Commission, there could only be CFCs established in third countries – there could never be non-CCCTB CFCs within the EU. In any case, in a CCCTB discussion draft

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72 Amanda Athanasiou, "*Competitive Interests Preventing Consensus on CFCs, Stack Says*" 2015 WTD 96-3 (May 19, 2015)

73 See comments of the Tax Executive Institute on the CFC Discussion Draft, in *"TEI Criticizes OECD's Strengthening CFC Rules Discussion Draft",* 2015 WTD 85-19 (30 April, 2015)

74 BEPS Monitoring Group, "Comments on BEPS Action 3: Strengthening the Rules on Controlled Foreign Corporations (CFCs)", available on: https://bepsmonitoringgroup.files.wordpress.com/2015/05/ap3-controlled-foreign-corporations.pdf

75 *Ibid*, page 4, para 6

76 *Ibid*, page 4, para 3

77 *Ibid*.

78 Brussels, COM(2011) 121/4, 2011/0058 (CNS); SEC(2011) 316 final

on the proposed anti-abuse rules for the purposes of the CCCTB,[79] the Commission, referring to its earlier Communication on anti-abuse measures[80] commented that "if CFC rules were to be introduced in the CCCTB they should be in line with the recent ECJ rulings". [81] This meant that "[t]o comply with the ECJ law either CFC rules are only to be applied in relation with third countries or CFC rules are also to be applied within the EU but, in this case, the rules should be targeted at wholly artificial arrangements only".[82] Perhaps a post-BEPS proposal on the CCCTB would now not set the threshold for CFC rules so high. Indicatively, the CFC provision proposed under the draft Anti-Tax Avoidance Directive[83] of the Commission's recently published Anti-Tax Avoidance Package, applies to both EU and third country CFCs.[84] Concerns were raised over this provision at the ECOFIN meeting of 25 May 2016. The adoption of the draft Directive was postponed to the next meeting.[85]

4. Limiting interest deductibility: Action 4

Action 4 mandated the OECD to develop recommendations in the form of best practices for the design of rules to prevent BEPS through interest expenses.[86] The primary concern appeared to be that multinational groups may be able to claim total interest deductions that significantly exceeded their actual third-party interest expense. As explained in the Interest Expense Discussion Draft,[87] such deductible payments can give rise to double non-taxation in both inbound and outbound investment scenarios. "From an inbound perspective, concerns focus on excess interest deductions reducing taxable profits in operating companies even in cases

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79 CCCTB/WP065\doc\en: "*CCCTB: Anti-Abuse rules*" (14-15/04/2008). See discussion in part 6, Christiana HJI Panayi, *The Common Consolidated Corporate Tax Base and the UK* (Institute for Fiscal Studies, 2011).

80 Commission Communication on Anti-Abuse Measures, COM (2007) 785

81 CCCTB/WP065\doc\en, *fn.* 79, para 29

82 *Ibid*.

83 See Part IV.3 below

84 See Arts 8-9 of draft Anti-Tax Avoidance Directive.

85 See Part IV.3

86 See Action 4: *"Develop recommendations regarding best practices in the design of rules to prevent base erosion through the use of interest expense, for example through the use of related-party and third-party debt to achieve excessive interest deductions or to finance the production of exempt or deferred income, and other financial payments that are economically equivalent to interest payments. The work will evaluate the effectiveness of different types of limitations. In connection with and in support of the foregoing work, transfer pricing guidance will also be developed regarding the pricing of related party financial transactions, including financial and performance guarantees, derivatives (including internal derivatives used in intra-bank dealings), and captive and other insurance arrangements. The work will be co-ordinated with the work on hybrids and CFC rules."*

87 OECD, *BEPS Action 4: Interest Deductions and Other Financial Payments*, published on 18 December 2014 (henceforth, Interest Expense Discussion Draft). Available on: http://www.oecd.org/ctp/aggressive/discussion-draft-action-4-interest-deductions.pdf For commentary, see Amanda Athanasiou and Lee A. Sheppard, "*BEPS Action 4 Draft Outlines Options for Interest Expense Deductions*", 2014 WTD 244-1(December 19, 2014); Emilio Cencerrado Millan & Maria Teresa Soler Roch, *"Limit Base Erosion via Interest Deduction and Others",* 43 (2015) 1 Intertax 58-71; Jan Vleggeert, "*Public Discussion Draft on Interest Deductions Proposes Worldwide Interest Allocation Rules*" 69 [2015] 4/5 Bulletin for International Taxation 297-305

where the group as a whole has little or no external debt. From an outbound perspective a company may use debt finance to produce tax exempt or deferred income, thereby claiming a deduction for interest expense while the related income is brought into tax later or not at all. Similar concerns are raised by payments under financial instruments such as guarantees and derivatives."[88]

In the Interest Expense Discussion Draft, it was suggested that an interest deductibility rule should apply to companies and other entities in three different scenarios; firstly, when they formed part of a corporate group, secondly, when they were under common control, but were not part of a corporate group (e.g. when a fund, individual or trust exercised the common control); and thirdly, when the parties were (otherwise) related, using a 25% common ownership test, or in the case of a structured arrangement.[89]

It was questioned whether a rule should operate by reference to the level of interest expense in an entity or the level of debt. It was also questioned whether a rule should focus on an entity's gross position (i.e. only its interest expense or debt liabilities) or its net position (i.e. also taking into account interest income or debt assets).[90] Factors in favour of each method were considered.

There was also a discussion on whether there should be a *de minimis* threshold, in order to reduce the level of compliance burden on entities and the administrative burden on tax authorities. Certain entities may pose a sufficiently low risk that excluding them from a rule would be appropriate. The Interest Expense Discussion Draft considered two ways to set a threshold below which entities would not be expected to apply the rule: based on an entity's size (a size threshold) or its level of net interest expense (a monetary threshold). It was not proposed that a threshold would be required as part of a best practice recommendation – it was up to countries to decide so.[91] Where a threshold was introduced, it should be set at an appropriate level, taking into account the economic and interest rate environment in the country. In addition, it was preferable that the threshold should apply to the total level of net interest expense in the local group to avoid groups fragmenting into multiple entities each applying a separate threshold.[92]

The Interest Expense Discussion Draft examined various methods of limiting taxpayers' excessive interest expense deductions. The methods included general rules which set an overall limit on the amount of interest expense in an entity, by linking interest deductibility to the position of a group or to fixed ratios, as well as targeted interest limitation rules which address specific base erosion and profit shifting risks. The Interest Expense Discussion Draft focused primarily on two approaches; firstly, a group-wide rule, which would limit a company's net interest deductions to a proportion of the group's actual net third party interest expense, and secondly, a fixed ratio rule, which would apply irrespective of the level of debt of a group and which would limit a company's interest deductions to an amount determined by applying a fixed benchmark ratio to an entity's earnings, assets or equity. Certain combinations

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88 Interest Expense Discussion Draft, p.2
89 *Ibid,* Part V
90 *Ibid*, Part VI
91 *Ibid*, para 57
92 *Ibid*.

of these two approaches and the use of more targeted approaches were also discussed.[93]

Written comments by industry and business representatives had denounced the OECD's groupwide approach and its rejection of the arm's length test. At the public consultation on 17 February 2015, it was argued that the proposed groupwide allocation would engender complexity and difficulties for both taxpayers and tax administrators. The proposal was also considered problematic, due to the temporal volatility in earnings, the unique circumstances of individual constituent entities, and the proposal's perverse incentive for increasing group indebtedness.[94] The leverage and interest ratios between entities may vary depending on the nature of their business, their stage in the business cycle, their size, the market in which they operate etc.[95] Furthermore, due to the differences in tax and accounting in different countries, applying the test might be a complex and cumbersome exercise.

Moreover, given that the Final Report on Action 4 provides a series of options of best practices rather than definite proposals, the inconsistent implementation of a groupwide rule could lead to double taxation. As countries will have some discretion, they may implement different versions of the rule. "All this would elevate the compliance burden and related costs to an unprecedented level".[96] A groupwide approach may also likely incentivise groups to increase third-party funding, which could create further economic distortions. As commented after the publication of the discussion draft, there was an overwhelming preference for a fixed ratio test, though it was also argued that a combined approach with a fixed ratio rule as the general rule and groupwide approach as the exception might be more sensible than all.

In the Final Report on Action 4, the OECD took some of these comments into account but did not overall deviate from this discussion draft very much. It endorsed the fixed ratio proposal limiting intercompany and third party interest expense for net interest of 10% to 30% of EBITDA, applied to net (including third party) interest at an entity level. There was also a recommendation for a Group Ratio Rule to enable groups that are more highly leveraged with third party debt to apply the worldwide ratio rather than the country's fixed ratio rule (possible 10% uplift to prevent double taxation). The Group Ratio Rule was a best practice rule based on the net third-party interest/EBITDA ratio of a financial reporting group, but countries could apply a different rule based on a relevant financial ratio. Alternatively, a country may choose not to apply any group ratio rule, provided the fixed ratio rule is applied to both multinational and domestic groups.

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93 *Ibid,* Part X. Each of these combined approaches included a general rule and then a carve-out from the general rule. "Approach 1" was a general group-wide interest allocation rule with a carve-out for entities meeting a low fixed-ratio test, to help alleviate the compliance costs in lower-risk situations. "Approach 2" was a fixed-ratio rule with a carve-out for entities that may permit them to deduct additional interest expense when the group's overall ratio exceeded the standard fixed ratio.

94 Ajay Gupta, *"BEPS Action 4: Keeping Formulary Apportionment at Bay",* 2015 WTD 45-3 (9 March 2015). Also see review of comments by Amanda Athanasiou and David D. Stewart, in "*OECD Action 4 Draft Consultation Focuses on Fixed Ratios*", 2015 WTD 32-1 (18 February, 2015)

95 Oliver R. Hoor and Keith O'Donnell, *" BEPS Action 4: When Theory Meets Practice",* Tax Notes Int'l, May 18, 2015, p. 643; 78 Tax Notes Int'l 643 (May 18, 2015)

96 *Ibid.*

Further options suggested were a *de minimis* threshold, a public benefit exemption, the carry-forward of disallowed interest expense and/or unused interest capacity, and other targeted anti-avoidance rules. These options were left to the discretion of countries, though in each case the report included suggestions on how they should be applied.

As suggested, both the fixed ratio and the group ratio rules directly linked an entity's net interest deduction to its level of taxable activity so as to eliminate the risk that deductible interest could be used to fund income which was not subject to tax.[97] This significantly reduced the risks posed by excessive intragroup debt and the location of third-party debt in high tax countries. The recommended approach also represented a workable solution for tax authorities and groups. The fixed ratio rule was based on similar tests applied in a number of countries. As it relied on information that an entity should already have access to in preparing its tax return, compliance costs should be minimal. The group ratio rule is more sophisticated, but the approach described in the Action 4 report ensures that the information required to calculate a group's net third-party interest/EBITDA ratio can all be taken from a group's consolidated financial statements or the underlying financial records used to prepare those financial statements. It is argued that a consistent approach between countries would ensure that the same information may be used by group entities in different countries, reducing the compliance burden on groups.

Overall, the Final Report's recommendations were in line with the expectations generated in the discussion draft. They were intended to facilitate convergence by countries but countries are also given flexibility to reflect their different circumstances by setting a benchmark fixed ratio within a range of 10% to 30%.

Implementation is crucial to these proposals. Some countries that have restrictions on interest deductions may be reluctant or slow to change. Some international investors are likely to be more affected than others e.g. infrastructure, PE, real estate and other "highly leveraged" groups. There will be further guidance in 2016 for banking and insurance sectors.

Since the BEPS reports were published, Norway and the UK have already announced consultations on interest limitation rules[98] based on the approach set out in the Final Report and other countries are expected to do so in the coming months. In addition, at least 10 countries now apply interest limitation rules which incorporate key elements of the approach. Work by the OECD is now continuing in this area.

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97 Mark Johnson & Oliver Petzold, "*Action 4: Limiting base erosion involving interest deductions and other financial payments*", International Tax Review, 1/4/2016

98 See, for example, the UK consultation documents on interest deductibility for corporate interest expenses. The first consultation was issued in October 2015 and is available on: https://www.gov.uk/government/consultations/tax-deductibility-of-corporate-interest-expense/tax-deductibility-of-corporate-interest-expense-consultation. This was updated on 12 May 2016. See https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/522936/tax_deductibility_second_consultation.pdf For commentary on the initial proposal, see BEPS Monitoring Group submission, available on: https://bepsmonitoringgroup.files.wordpress.com/2016/01/uk-interest-deduction-consultation-final.pdf

5. Revamping the work on harmful tax practices: Action 5

Whilst the bulk of the work under the BEPS Action Plan is directed at the position and actions of taxpayers, Action 5 largely focuses on the actions of countries. Under this Action item, the Forum on Harmful Tax Practices (FHTP) was committed to revamp the work on harmful tax practices with a priority and renewed focus on requiring substantial activity for any preferential regime and on improving transparency through compulsory spontaneous exchange of rulings related to preferential regimes.[99] The FHTP was expected to take a holistic approach to evaluate preferential tax regimes in the BEPS context and to engage with non-OECD members.

The OECD deliverable on Action 5 was released for the first time in September 2014.[100] Almost half of the discussion draft was devoted to the OECD's previous work on harmful tax practices – the 1998 Harmful Tax Competition Report[101] and its aftermath. The work under Action 5 was seen as an extension to this. The FHTP was now asked to 'revamp' its work on harmful tax practices,

Emphasis was placed on elaborating a methodology to define a substantial activity requirement in the context of intangible property.[102] This is understandable given that the taxation of intangible property was at the heart of the BEPS project.[103] The OECD recognised that there had been a shift by countries from creating ring-fenced tax regimes towards introducing more broadly based corporate tax reductions for particular types of income, such as financial activities or intangibles.[104]

In defining substantial activity, the Harmful Tax Practices Discussion Draft focused primarily on the nexus approach.[105] This looked at whether an intellectual property (IP) regime made its benefits conditional on the extent of research and development (R&D) activities of taxpayers receiving benefits. Under this approach, expenditures

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99 For the full wording, see Action 5 of the BEPS Action Plan which reads as follows: *"Revamp the work on harmful tax practices with a priority on improving transparency, including compulsory spontaneous exchange on rulings related to preferential regimes, and on requiring substantial activity for any preferential regime. It will take a holistic approach to evaluate preferential tax regimes in the BEPS context. It will engage with non-OECD members on the basis of the existing framework and consider revisions or additions to the existing framework."*

100 OECD (2014), *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing (henceforth, Harmful Tax Practices Discussion Draft).

101 OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publishing, 1998)

102 Harmful Tax Practices Discussion Draft, p.28

103 *Ibid*, p.28

104 *Ibid*.

105 Other approaches considered were the value creation approach and the transfer pricing approach. The value creation approach required taxpayers to undertake a set number of significant development activities. The transfer pricing approach would allow a regime to provide benefits to all the income generated by the IP if the taxpayer had located a set level of important functions in the jurisdiction providing the regime, if the taxpayer was the legal owner of the assets giving rise to the tax benefits and used the assets giving rise to the tax benefits, and if the taxpayer bore the economic risks of the assets giving rise to the tax benefits. *Ibid*, pp.28-29. The third approach, the nexus approach, was preferred.

act as a proxy for substantial activities.[106] The nexus approach sought to build on the basic principle underlying R&D credits and similar "front-end" tax regimes that apply to expenditures incurred in the creation of IP. It extended this basic principle to "back-end" tax regimes that apply to the income earned after the creation and exploitation of the IP. Therefore, the initially proposed nexus approach would allow countries to extend their jurisdiction beyond IP regimes that only provide benefits directly to the expenditures incurred to *create* the IP, permitting jurisdictions to provide benefits to the income arising out of that IP – so long as there is a direct nexus between the income receiving benefits and the expenditures contributing to that income.

The nexus approach applied a proportionate analysis to income, under which the proportion of income that may benefit from an IP regime was the same proportion as that between qualifying R&D expenditures and overall R&D expenditures.[107] Calculations under the formula would be treated as a rebuttable presumption.[108] The purpose of this approach was to grant benefits only to income that arises from IP where the actual R&D activity was undertaken by the taxpayer itself. This goal was achieved by defining "qualifying expenditures" in a way that prevented mere capital contribution or expenditures for substantial R&D activity by parties other than the taxpayer from qualifying the subsequent income for benefits under an IP regime. The various concepts were analysed extensively in the discussion draft.

Taxpayers wanting to benefit from an IP regime must track expenditures, IP assets, and income to ensure that the income receiving benefits did in fact arise from the expenditures that qualified for those benefit. Each jurisdiction had to establish procedures for tracking and tracing based on consistent criteria capable of objective measurement.[109]

On 11 November 2014, Germany and the UK announced a proposal to modify the OECD's nexus approach,[110] which would also curb the UK patent box regime.[111] This was subsequently endorsed by all OECD and G20 countries. The agreed modified nexus approach[112] maintains the underlying principle of the nexus

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106 *Ibid*, p.29

107 *Ibid*. For complex business models with multiple strands of income and expenditure, a more complicated formula was recommended.

108 Harmful Tax Practices Discussion Draft, p.30

109 *Ibid*, p.34

110 See Germany- UK Joint Statement, available on: https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/373135/GERMANY_UK_STATEMENT.pdf

111 Under the UK regime, companies could apply a lower rate of corporation tax (10%) to profits earned after 1 April 2013 from its patented inventions. A company could benefit from the patent box if it owned or exclusively licensed-in patents granted by the UK Intellectual Property Office, the European Patent Office and several EEA countries (namely, Austria, Bulgaria, Czech Republic, Denmark, Estonia, Finland, Germany, Hungary, Poland, Portugal, Romania, Slovakia and Sweden). See HMRC guidance available on: https://www.gov.uk/corporation-tax-the-patent-box Therefore, benefits were given even if the qualifying IP was developed outside of the UK. See HJI Panayi (2015), *fn*.35, chapter 5.

112 See *Explanatory Paper - Agreement on Modified Nexus Approach for IP Regimes*, available on: http://www1.oecd.org/ctp/explanatory-paper-beps-action-5-agreement-on-modified-nexus-approach-for-ip-regimes.pdf . For the full report, see *Action 5: Agreement on Modified Nexus Approach for IP Regimes* (OECD 2015), available on: http://www.oecd.org/ctp/beps-action-5-agreement-on-modified-nexus-approach-for-ip-regimes.pdf

approach proposed in the September 2014 Harmful Tax Practices Discussion Draft but makes some important amendments, following the UK-Germany proposal.

Pursuant to the modified nexus approach, a 30% uplift would be allowed to increase the value of the eligible R&D expenditure proxy for outsourcing or acquisition costs. The 30% uplift to the qualifying expenditures would reflect expenditures for R&D activities outsourced to related parties and IP acquisition costs.[113] Broadly, the revised formula would allow the IP box company, when calculating benefits due under the preferential regime, to take into account related party outsource expenditure (and any IP acquisition costs), subject to a cap on actual expenditure. This provision was introduced to reduce the negative impact of an IP box company choosing to outsource R&D activities to group companies.[114]

In this context, it was agreed that existing regimes would be closed to new entrants in respect of both products and patents by June 2016.In addition, there would be no new entrants to such IP regimes after 30 June 2016.[115] The modified nexus approach was adopted in the Final Report on Action 5.[116]

It is generally thought that the nexus principle will introduce considerable complexity to IP box regimes. For many taxpayers, it is likely to restrict overall benefits, particularly to those groups operating multiple R&D centres on a global basis. Moreover, to an extent, any nexus approach which focuses on economic presence to justify income in a country poses the risk of worsening any adverse economic effects of tax competition, as it creates an incentive for taxpayers to move people and activities from high-tax to low-tax jurisdictions. This could be harmful as well. Although the issue was raised even before the revision of the nexus approach,[117] unfortunately, it has not been addressed in the discussion documents. Whether or not the modified nexus approach will reconfigure the parameters of the tax competition debate in such a way as to be deemed to create more rather than less tax-induced relocations and economic distortions remains to be seen.

In the area of transparency, a framework covering all rulings that could give rise to BEPS concerns in the absence of compulsory spontaneous exchange was agreed.[118] For countries which had the necessary legal basis, exchange of information under this framework would take place from 1 April 2016 for future rulings and the exchange of certain past rulings would need to be completed by 31 December 2016. The Final Report also set out best practices for cross-border rulings.

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113 Gupta, *"Modifying the Modified Nexus Approach – Behind Closed Doors"*

114 See Jonathan Bridges, *"The Q&A: The UK/German proposal for preferential IP regimes*", Tax Journal, Issue 1240, 8 (21 November 2014)

115 There is a long grandfathering period, under which benefits can continue to be claimed until June 2021.

116 OECD (2015), Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: http://dx.doi.org/10.1787/9789264241190-en

117 Amanda Athanasiou, *"The Cost of BEPS",* 2015 WTD 9-1 (14 January, 2015)

118 The framework covered six categories of rulings: (i) rulings related to preferential regimes; (ii) cross-border unilateral advance pricing arrangements (APAs) or other unilateral transfer pricing rulings; (iii) rulings giving a downward adjustment to profits; (iv) permanent establishment (PE) rulings; (v) conduit rulings; and (vi) any other type of ruling where the FHTP agrees in the future that the absence of exchange would give rise to BEPS concerns.

The results of the review of 43 preferential regimes, including 16 IP regimes were included in the report and the FHTP's work on reviewing preferential regimes was expected to continue. The FHTP would also review the implementation of the transparency framework.

Work would continue so as to engage with non-OECD/non-G20 countries to achieve a level playing field and avoid the risk that harmful tax practices are simply displaced to third countries. This was also aligned with the OECD/G20's aim to encourage an inclusive framework on BEPS implementation, to heed off criticism that the UN was side-lined in this project. Close cooperation would continue with the European Commission so as to ensure maximum coherence in their policy and the efficient and streamlined translation of global standards within the EU arena.119 Indeed, the European Union has been at the forefront of developments regarding the automatic exchange of tax rulings, as discussed in Part IV.3 below.

6. Tackling treaty shopping: Action 6

The Action Plan identified treaty abuse, and in particular treaty shopping, as one of the most important sources of BEPS concerns. Under Action 6 of the Action Plan, the OECD was to develop model treaty provisions and recommendations for the prevention of treaty shopping.

The first discussion draft, which set out the main parameters of the proposals, was published in March 2014 (Treaty Abuse Discussion Draft).120 There was a second discussion draft in September 2014 (Treaty Abuse Revised Discussion Draft)121 and a follow-up report in November 2014 (Treaty Abuse Follow-Up Report).122

The final proposals, encapsulated in the Final Report on Action 6,123 reflected the agreement by OECD and G20 countries to adopt a minimum standard that will effectively address treaty shopping and other treaty abuse strategies that may be used to obtain treaty benefits in situations where such benefits were not intended to be granted.

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119 Also see Kate Ramme, "*Action 5: Countering harmful tax practices more effectively, taking into account transparency and substance*", International Tax Review, 1/4/2016, p.24
120 OECD, *BEPS Action 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances* – 14 March 2014 – 9 April 2014. Available on: http://www.oecd.org/ctp/treaties/treaty-abuse-discussion-draft-march-2014.pdf
121 OECD/G20 Base Erosion and Profit Shifting Project, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2014 Deliverable* (OECD). Available on: http://www.oecd-ilibrary.org/docserver/download/2314281e.pdf?expires=1433339357&id=id&accname=guest&checksum=B5EBBB1C513F73A6C49C3D79ECAC8E12
122 OECD, *Follow Up Work on BEPS Action 6: Preventing Treaty Abuse*. Available on: http://www.oecd.org/ctp/treaties/discussion-draft-action-6-follow-up-prevent-treaty-abuse.pdf
123 OECD (2015), Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: http://dx.doi.org/10.1787/9789264241695-en

Under the minimum standard of Action 6, countries would include in the title and preamble of their tax treaties an express statement that their common intention is to eliminate double taxation without creating opportunities for non-taxation or reduced taxation through tax avoidance or evasion, including through treaty shopping arrangements. This would provide a clear statement of the intention of the signatories to the tax treaty, which would be relevant to the interpretation of the tax treaty for the purposes of Article 31(1) of the Vienna Convention.

The minimum standard also required countries to implement this common intention through the adoption of specific tax treaty rules to prevent treaty abuse. There were two different treaty-based rules relating to this.

Firstly, there was the limitation-on-benefits (LOB) rule which limited the availability of treaty benefits to entities that met certain conditions. These conditions, which were based on the legal nature, ownership in, and general activities of the entity, sought to ensure that there was a sufficient link between the entity and its State of residence. Such LOB were currently found in treaties concluded by a few countries and had proven to be effective in preventing many forms of treaty shopping. The recommended wording for the LOB clause was expected to be finalised in 2016, following the finalisation of the new US model tax treaty[124] and the guidelines on treaty entitlement of non-CIVs.[125]

Secondly, there was the more general principal purposes test (PPT). Under this rule, if one of the principal purposes of transactions or arrangements was to obtain treaty benefits, these benefits would be denied unless it was established that granting these benefits would be in accordance with the object and purpose of the provisions of the treaty.

It was recognised that each of the LOB and PPT rules had strengths and weaknesses and may not be appropriate for or accord with the treaty policy of all countries. A flexible approach to the adoption of these two rules was recommended, pursuant to which the Action 6 minimum standard would be satisfied through a combined approach, whereby a tax treaty included both the LOB and PPT rules, or a tax treaty included solely the PPT rule, or only the LOB rule, supplemented by other mechanisms[126] that would deal with conduit arrangements not already dealt with in tax treaties.

The Final Report on Action 6 also contained several other recommendations, not included in the Action 6 minimum standard, for specific anti-abuse rules.[127]

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124 See US Model Tax Convention 2016, available at: https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf Also see Preamble to US Model published on 17 February 2016, available at: https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Preamble-US%20Model-2016.pdf

125 See OECD discussion document published on 23 March 2016, available at: http://www.oecd.org/tax/treaties/beps-consultation-treaty-entitlement-non-civ-funds.htm

126 E.g. a limited, treaty-based PPT rule restricted to conduit arrangements or domestic law provisions that would achieve a similar result.

127 These recommendations included a minimum shareholding period to benefit from the direct dividend rate provided by Article 10(2)(a); an amendments to Article 13(4) to prevent the avoidance of the application of that provision to certain indirect alienations of immovable property; a new Article

The Final Report concluded by addressing the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The policy considerations described in the report should help countries explain their decisions not to enter into tax treaties with certain low or no-tax jurisdictions. These policy considerations would also be relevant for countries that need to consider whether they should modify or, ultimately, terminate a treaty previously concluded in the event that a change of circumstances (such as changes to the domestic law of a treaty partner) raises BEPS concerns related to that treaty. These considerations would be incorporated in a number of new paragraphs in the Introduction of the OECD Model Tax Convention.

The anti-abuse measures that were agreed under Action 6 are expected to be a central component of the multilateral instrument which is being negotiated to implement the treaty-related BEPS measures. The European Commission has also endorsed them and recommended their application to the extent compatible with EU law.[128] In the recent Recommendation on implementation of measures to tackle tax treaty abuse,[129] Member States were urged to implement the OECD's BEPS proposals to address tax treaty abuse. Where Member States include in tax treaties a GAAR based on a principal purpose test (PPT) as suggested in the Action 6 of BEPS, the Commission recommended that the rule should be modified to comply with EU case law such that genuine economic activity is not affected.[130]

7. Prevent the Artificial Avoidance of PE Status: Action 7

As the PE definition in Article 5 of the OECD Model had not changed since 1977, it was not surprising that tax avoidance strategies used to inappropriately circumvent the PE status had increased. The rapid evolution of the global economy and the emergence of new business models had exacerbated this. Action 7 called for the PE definition to be reviewed and updated in order to prevent the artificial avoidance of the PE status in relation to BEPS.[131]

4(3) tie-breaker rule pursuant to which the competent authorities will determine the treaty residence of dual-resident entities; an anti-abuse rule for permanent establishments in third states; and a 'saving clause' which operates to confirm a contracting state's right to tax its own residents notwithstanding the provisions of the treaty (except those, such as the rules on relief of double taxation, that are clearly intended to apply to residents).

128 See Part IV.3 below

129 C(2016) 271 final

130 Also see Part IV.3 below

131 See Action Plan, pp.19-20. Action 5 read as follows: *"Develop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS, including through the use of commissionaire arrangements and the specific activity exemptions. Work on these issues will also address related profit attribution issues."*

On 31 October 2014, the OECD released its first discussion draft on the topic (the PE Discussion Draft).[132] There were no major surprises in this discussion draft and some of the proposals were foreshadowed in the discussions over Action 1. Proposals for changes to the PE definition in the OECD Model were suggested in order to prevent abuse of the PE threshold through commissionaire arrangements[133] and the specific activity exemptions.[134] These strategies were aimed at avoiding the application of the dependent-agent PE provision in Article 5(5) of the OECD Model.

The work on Action 7 led to proposals to change Article 5(5) and 5(6) of the OECD Model which were included in the final report. The revised proposals would result in a significant extension to the definition of a PE, though these proposals were slightly narrowed compared to earlier proposals. The circumstances in which a "dependent agent" PE can be created will be significantly widened - it will extend to situations where a person habitually plays the principal role leading to the conclusion of contracts that are routinely concluded without material modification by the enterprise.

The Final Report[135] on Action 7 also looked at the specific activity exceptions to the PE definition in Article 5(4) of the OECD Model. To ensure that profits derived from core business activities performed in a country through a fixed place of business can be taxed in that country, Article 5(4) should be modified to ensure that each of the exceptions included in that paragraph is subject to the requirement that the listed activities are of a 'preparatory or auxiliary' character. The Final Report also contained a new anti-fragmentation rule to address the breaking up of a cohesive business into several distinct operations carried on by the same or a closely related enterprise, so that each part is considered as merely engaged in preparatory or auxiliary activities that benefit from the exceptions in Article 5(4).

The need for additional guidance on the issue of attribution of profits to PEs was recognised, in particular to provide greater certainty regarding the determination of

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132 Public Discussion Draft, *BEPS Action 7: Preventing Artificial Avoidance of PE Status* (OECD, 2014). Available on: http://www.oecd.org/tax/treaties/action-7-pe-status-public-discussion-draft.pdf

133 On commissionaire arrangements, see Executive Summary, pp.9-10: "A commissionaire arrangement may be loosely defined as an arrangement through which a person sells products in a State in its own name but on behalf of a foreign enterprise that is the owner of these products. Through such an arrangement, a foreign enterprise is able to sell its products in a State without technically having a permanent establishment to which such sales may be attributed for tax purposes and without, therefore, being taxable in that State on the profits derived from such sales. Since the person that concludes the sales does not own the products that it sells, that person cannot be taxed on the profits derived from such sales and may only be taxed on the remuneration that it receives for its services (usually a commission). A foreign enterprise that uses a commissionaire arrangement does not have a permanent establishment because it is able to avoid the application of Article 5(5) of the OECD Model Tax Convention, to the extent that the contracts concluded by the person acting as a Commissionaire are not binding on the foreign enterprise. Since Article 5(5) relies on the formal conclusion of contracts in the name of the foreign enterprise, it is possible to avoid the application of that rule by changing the terms of contracts without material changes in the functions performed in a State. Commissionnaire arrangements have been a major preoccupation of tax administrations in many countries, as shown by a number of cases dealing with such arrangements that were litigated in OECD countries. In most of the cases that went to court, the tax administration's arguments were rejected."

134 For an excellent review, see Arthur Pleijsier, "*The Agency Permanent Establishment in BEPS Action 7: Treaty Abuse or Business Abuse?*", 43 [2015] 2 Intertax 147-154

135 OECD (2015), Preventing the Artificial Avoidance of Permanent Establishment Status, Action 7 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: http://dx.doi.org/10.1787/9789264241220-en

the profits that would be attributable to the PEs following the proposed. These proposals were a central component of the multilateral instrument to be negotiated in 2016. Overall, it could be argued that the proposals in the Final Report remain less precise than the current PE definition and are expected to generate significant uncertainty for business.

8. The survival of the arm's length principle: Actions 8-10

Transfer pricing was at the heart of the BEPS project and a key element of the comprehensive package of measures to address concerns relating to base erosion and profit shifting.[136] The BEPS project sought to address the problematic nature of certain topics in this area focusing on issues such as intangibles, cost contribution arrangements, profit splits, commodities, risk and capital and other high risk transactions.

The work focused on three key areas. Work under Action 8 looked at transfer pricing issues relating to transactions involving intangibles, since misallocation of profits generated by valuable intangibles contributed to base erosion and profit shifting. Work under Action 9 considered the contractual allocation of risks, and the allocation of profits to those risks. It also considered the level of returns to funding provided by a capital-rich MNE group member, where those returns do not correspond to the level of activity undertaken by the funding company. Work under Action 10 focused on other high-risk areas.[137]

The Final Report on Actions 8-10, contained revised guidance seeking to ensure that the transfer pricing rules secure outcomes that see operational profits allocated to the economic activities which generate them – i.e. that transfer pricing outcomes are in line with value creation. The revised guidance will eventually be incorporated in the Transfer Pricing Guidelines, a new version of which has not yet been released post-BEPS.

As regards intangibles, it is proposed that legal ownership of an intangible would not of itself provide a right to all (or even any) of the return generated from its exploitation. Rather, those returns would accrue to the entities which carry out certain functions in relation to that intangible: namely, development, enhancement, maintenance, protection and exploitation. Specific guidance would ensure that the analysis is not weakened by information asymmetries between the tax administration and the taxpayer in relation to hard-to-value intangibles, or by using special contractual relationships, such as a cost contribution arrangement.

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136 Andrew Hickman, Melinda Brown, Mayra Lucas, "*Actions 8-10: Aligning transfer pricing outcomes with value creation*", International Tax Review. 1/4/2016, p16

137 OECD (2015), Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 - 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: http://dx.doi.org/10.1787/9789264241244-en. Pages 9-10

The revised guidance required careful delineation of the actual transaction between the associated enterprises by analysing the contractual relations between the parties in combination with the conduct of the parties. The conduct would supplement or replace the contractual arrangements if the contracts were incomplete or were not supported by the conduct.[138] Transactions could be disregarded for transfer pricing purposes where they lacked commercial rationality.

Risks were defined as the effect of uncertainty on the objectives of the business. Return for risk was allocated to the party which controlled it and had the financial capacity to assume it. An entity only providing capital would be entitled to no more than a risk-free return.

Enhanced rules on how to apply the CUP (comparable uncontrolled price) method to commodity transactions were included. Also, safe harbour rules for low value adding services were recommended. Furthermore, there were changes to the rules on Cost Contribution Arrangements to align them with the other transfer pricing outcomes.

As part of the Final Report, a mandate was included for follow-up work to be done on the transactional profit split method, which would be finalised by 2017. According to the OECD, the guidance was linked in a holistic way with other Actions[139] and especially Actions 3-4, 6, 13-14.

These recommendations cement the importance of underlying substance and value creation over legal ownership and/or funding. They are consistent with the overall evolution of the tax treatment of intangibles, risks and capital. Arguably, other than the clarification that contractual terms should continue to be recognised when they are aligned with the underlying economic conduct and the significance of the financial capacity to assume risk, there is little change from the previous discussion drafts.

This work, together with Action 13 of BEPS on transfer pricing documentation and country-by-country reporting (CbCR), is expected to enhance transparency and provide tax administrations with instruments to tackle the transfer pricing risks identified in the BEPS Action Plan. The report also concludes that, at this stage, the countries involved in the BEPS project do not consider that special measures outside the arm's length principle are needed to address the BEPS challenges posed in the transfer pricing area. Therefore, notwithstanding initial hopes of some (mainly NGOs) that with BEPS the OECD would finally reconsider the use of the arm's length principle as the cornerstone of transfer pricing and explore other methods such as formulary apportionment, the conclusions of the Final Report suggest that the OECD is still firmly embedded in the arm's length principle.

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138 *Ibid*, p.10
139 *Ibid*, p.11-12

9. Establish methodologies to collect and analyse data on BEPS and the actions to address it: Action 11

The Final Report[140] on Action 11 did not include any new proposals for changing international tax rules – rather, it was focused on measuring the size and extent of BEPS activities. Action 11 was intended to estimate the size of BEPS, to identify indicators of BEPS, and to provide recommendations for improving the measurement of BEPS.[141] The report estimated that BEPS reduces global corporate income tax revenue by 4%-10% (i.e., US$100 billion to US$240 billion annually).

The OECD sets out six indicators that point to BEPS activity costing governments between USD 100 billion and USD 240 billion a year in lost tax revenues.[142] The indicators highlight BEPS behaviours using different sources of data, employing different metrics, and examining different BEPS channels. When combined and presented as a dashboard of indicators, they confirm the existence of BEPS, and its continued increase in scale in recent years.

While recognising the need to maintain appropriate safeguards to protect the confidentiality of taxpayer information, this report makes a number of recommendations that will improve the analysis of available data.[143] The recommendations cover data to be collected by governments and methodologies to analyse data, as well as the consistent presentation of data. Improved data and analysis tools are intended to lead to better identification of any BEPS activities occurring and the impact of actions taken to address BEPS. Overall, it is difficult to assess the success of the proposed tools in monitoring BEPS until the rest of the actions are implemented more widely in a variety of jurisdictions.

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140 OECD (2015), Measuring and Monitoring BEPS, Action 11 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: http://dx.doi.org/10.1787/9789264241343-en

141 Action 11 of the BEPS Action Plan reads as follows: *"Develop recommendations regarding indicators of the scale and economic impact of BEPS and ensure that tools are available to monitor and evaluate the effectiveness and economic impact of the actions taken to address BEPS on an ongoing basis. This will involve developing an economic analysis of the scale and impact of BEPS (including spillover effects across countries) and actions to address it. The work will also involve assessing a range of existing data sources, identifying new types of data that should be collected, and developing methodologies based on both aggregate (e.g. FDI and balance of payments data) and micro-level data (e.g. from financial statements and tax returns), taking into consideration the need to respect taxpayer confidentiality and the administrative costs for tax administrations and businesses."*

142 The indicators, set out in pp. 15-16 of the Final Report, were the following:

(1) The profit rates of MNE affiliates located in lower-tax countries are higher than their group's average worldwide profit rate.

(2) The effective tax rates paid by large MNE entities are estimated to be 4 to 8½ percentage points lower than similar enterprises with domestic-only operations, distorting the level playing field.

(3) Foreign direct investment (FDI) is increasingly concentrated. FDI in countries with net FDI to GDP ratios of more than 200% increased from 38 times higher than all other countries in 2005 to 99 times higher in 2012.

(4) The separation of taxable profits from the location of the value creating activity is particularly clear with respect to intangible assets, and the phenomenon has grown rapidly.

(5) Debt from both related and third-parties is more concentrated in MNE affiliates in higher statutory tax-rate countries.

143 See p.16 of the Executive Summary and chapter 4.

10. Require Taxpayers to Disclose their Aggressive Tax Planning Arrangements: Action 12

The Final Report[144] on Action 12 provided a modular framework that enabled countries without mandatory disclosure rules to design a regime that fits their need to obtain early information on potentially aggressive or abusive tax planning schemes and their users.[145] The recommendations did not represent a minimum standard and countries were free to choose whether or not to introduce mandatory disclosure regimes. Where a country wished to adopt mandatory disclosure rules, the recommendations provided the necessary flexibility to balance a country's need for better, more comprehensive and timely information with the appropriate compliance burdens for taxpayers.[146]

The Final Report also set out specific recommendations for rules targeting international tax schemes, as well as for the development and implementation of more effective information exchange and cooperation between tax administrations. The implementation had to be balanced with country specific needs and existing compliance and disclosure initiatives. The Final Report also included information on how mandatory disclosure contributed towards enhanced transparency between tax administrations.

Transparency was one of the three central pillars of the BEPS Project. A number of measures developed in the course of the BEPS Project, including Action 12, would give rise to greater information sharing between tax administrations. The expanded Joint International Tax Shelter Information and Collaboration Network (JITSIC Network), which would act under the umbrella of the OECD Forum on Tax Administration was considered well positioned to act as a joint intelligence platform for analysing and exchanging relevant information including information on international schemes obtained under a mandatory disclosure regime.

It has been argued that an effort should be made so that mandatory disclosure rules do not just focus on small and medium-sized enterprises and wealthy individuals, but

144 OECD (2015), Mandatory Disclosure Rules, Action 12 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: http://dx.doi.org/10.1787/9789264241442-en

145 Action 12 of the BEPS Action Plan reads as follows: *"Develop recommendations regarding the design of mandatory disclosure rules for aggressive or abusive transactions, arrangements, or structures, taking into consideration the administrative costs for tax administrations and businesses and drawing on experiences of the increasing number of countries that have such rules. The work will use a modular design allowing for maximum consistency but allowing for country specific needs and risks. One focus will be international tax schemes, where the work will explore using a wide definition of "tax benefit" in order to capture such transactions. The work will be co-ordinated with the work on co-operative compliance. It will also involve designing and putting in place enhanced models of information sharing for international tax schemes between tax administrations."*

146 *Ibid*, page 9

also cover MNEs. Existing domestic rules tend to target standard schemes which are widely marketed by promoters, whereas MNEs generally use arrangements tailored to their specific needs, even if based on standard techniques. The BEPS Monitoring Group gave as an example the tax clearances arranged by PwC in Luxembourg over a period of eight years for 343 MNEs that were not notified under the UK's disclosure regime.[147]

The BEPS Monitoring Group has urged for any disclosure rules to be adapted to international corporate tax avoidance and to include hallmarks to that effect. "Like all methods of improving compliance, mandatory disclosure must balance deterrence with cooperation. However, there should be safeguards against the pitfalls experienced by some forms of 'cooperative compliance', which have led to public concerns about 'sweetheart deals'."[148] Provisions for access to information derived from notification by a wide range of other tax authorities, and standards for reporting to the public of information and data from disclosure arrangements would help.[149] Such measures would not only improve transparency but also facilitate the independent evaluation of the effects of mandatory disclosure schemes.

11. Re-Examine Transfer Pricing Documentation: Action 13

The effective implementation of the arm's length principle is very much linked to the availability of information. Asymmetry of information between taxpayers and tax administrations can be acute especially in a transfer pricing scenario, thus leading to opportunities for BEPS. Enhancing transparency in general, and for transfer pricing purposes in particular was therefore crucial to the success of the BEPS project.[150]

The three discussion documents previously released in the context of Action 13[151] were consolidated to create the text of a new Chapter V of the OECD Guidelines. As such, a three-tiered standardised approach to transfer pricing documentation was developed, which was encapsulated in the Final Report[152] on Action 13.

First, the guidance on transfer pricing documentation required MNEs to provide tax administrations with high-level information regarding their global business operations

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147 BEPS Monitoring Group, *Comments on BEPS Action 12: Mandatory Disclosure Rules,* available on: https://bepsmonitoringgroup.files.wordpress.com/2015/05/ap12-mandatory-disclosure-rules.pdf
148 *Ibid*, p.1
149 *Ibid*.
150 Andrew Hickman, Samia Abdelghani, Paul Hondius, "*Action 13: Transfer pricing documentation and country-by-country reporting*", International Tax Review. 1/4/2016, p1
151 Action 13 of the BEPS project reads as follows: *"Develop rules regarding transfer pricing documentation to enhance transparency for tax administration, taking into account the compliance costs for business. The rules to be developed [would] include a requirement that MNEs provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template."*
152 OECD (2015),Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. http://dx.doi.org/10.1787/9789264241480-en

and transfer pricing policies in a "master file" that was to be available to all relevant tax administrations.

Second, it required that detailed transactional transfer pricing documentation be provided in a "local file" specific to each country, identifying material related party transactions, the amounts involved in those transactions, and the company's analysis of the transfer pricing determinations they have made with regard to those transactions.

Third, large MNEs were required to file a country-by-country report that would provide annually and for each tax jurisdiction in which they do business the amount of revenue, profit before income tax and income tax paid and accrued. It also required MNEs to report their number of employees, stated capital, retained earnings and tangible assets in each tax jurisdiction. Finally, it required MNEs to identify each entity within the group doing business in a particular tax jurisdiction and to provide an indication of the business activities each entity engages in.

It was expressly stated that the country-by-country report would be used as a high-level risk assessment tool and not as the basis to propose transfer pricing adjustments using a global formulary apportionment of income.[153] Tax administrations should also take reasonable steps to ensure that the information was not released to the public.[154]

It was argued that the master file, local file and Country-by-Country Report, taken together, would make taxpayers articulate consistent transfer pricing positions and would provide tax administrations with useful information "to assess transfer pricing risks, make determinations about where audit resources can most effectively be deployed, and, in the event audits are called for, provide information to commence and target audit enquiries".[155] This information was expected to make it easier for tax administrations to identify whether companies have engaged in practices that have the effect of artificially shifting income into tax-advantaged environments.

MNEs have to deliver the master file and the local file directly to local tax administrations. There would be *no* public country-by-country reporting.[156] Country-

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153 *Ibid,* para 25 of new Chapter V of OECD Transfer Pricing Guidelines. For a discussion of the concerns that the information provided under country-by-country reporting might lead to formulary apportionment see Maria Amparo Grau Ruiz, "*Country-by-Country Reporting: The Primary Concerns Raised by a Dynamic Approach*", 68 [2014] 10 Bulletin for International Taxation 557-566

154 See paras 18-21 of new Chapter V of OECD Transfer Pricing Guidelines, set out in the CbC Revised Discussion Draft. The formal citation of this discussion draft is: OECD, *Guidance on Transfer Pricing Documentation and Country-by-Country Reporting* (2014), available on: http://www.oecd.org/tax/guidance-on-transfer-pricing-documentation-and-country-by-country-reporting-9789264219236-en.htm)

155 Final Report on Action 13, Executive summary, p.9

156 In the initial discussion draft (see OECD, *Discussion Draft on Transfer Pricing Documentation and CbC Reporting* (30 January 2014), available on: http://www.oecd.org/ctp/transfer-pricing/discussion-draft-transfer-pricing-documentation.pdf), it was uncertain and open for discussion how the master file and country-by-country report, once prepared, would be shared among participating country tax authorities. Concerns had already been noted about the confidentiality of the data.
The CbC Revised Discussion Draft stipulated that tax administrations should take all reasonable steps to ensure that there was no public disclosure of confidential information and other commercially sensitive information contained in the documentation package. Tax administrations should also assure

by-country reports should be filed in the jurisdiction of tax residence of the ultimate parent entity and should be shared between jurisdictions through automatic exchange of information. This is expected to be done through adoption of the multilateral Convention on Mutual Administrative Assistance in Tax Matters, bilateral tax treaties and/or tax information exchange agreements (TIEAs). In limited circumstances, secondary mechanisms, including local filing can be used as a backup.

In order to facilitate the implementation of the new reporting standards, an implementation package was developed consisting of model legislation which could be used by countries to require MNE groups to file the Country-by-Country Report and competent authority agreements that were to be used to facilitate implementation of the exchange of those reports among tax administrations.

Consistent and effective implementation of the Country-by-Country requirements was essential for the success of BEPS. These new Country-by-Country reporting requirements were to be implemented for fiscal years beginning on or after 1 January 2016 and apply, subject to the 2020 review, to MNEs with annual consolidated group revenue equal to or exceeding EUR 750 million. It was acknowledged that some jurisdictions may need time to follow their particular domestic legislative process in order to make necessary adjustments to the law.

Work was expected to continue at a local country level on the domestic implementation of the OECD recommendations in respect of the Master File, the Local File and the Country by Country reporting (CbCR).

Notwithstanding the business sector's concerns on the compliance burden that would fall on MNEs as a result of these proposals, country-by-country reporting has becoming a reality – perhaps one of the flagship outcomes of the BEPS project. Several countries have already announced new legislation to implement all three elements of Action 13, as explained in Part V.2. Furthermore, the European Commission has proposed changes to the Mutual Assistance Directive to comply with Action 13 of BEPS project, by requiring automatic exchange of country-by-country reports. In fact, following the Panama leaks, the European Commission made a proposal to require *public* country-by-country reporting for large MNEs. The EU developments are discussed in further detail below in Part IV.

12. Making dispute resolution mechanisms more effective: Action 14

taxpayers that the information presented in transfer pricing documentation would remain confidential. This stipulation was in rather vague terms and did not meet the concerns of stakeholders for more certainty. The CbC Revised Discussion Draft referred to the OECD Guide 'Keeping It Safe' on the protection of confidentiality. (The OECD Guide 'Keeping It Safe' is available on: http://www.oecd.org/ctp/exchange-of-tax-information/keeping-it-safe-report.pdf) This report contained useful guidelines which were more suitable to bilateral scenarios and not necessarily tailored to the multi-jurisdictional reporting setting envisaged in the CbC Revised Discussion Draft. See HJI Panayi (2015), *fn.*35, chapter 4.

The measures developed under Action 14 aimed to strengthen the effectiveness and efficiency of the mutual assistance procedure (MAP) process, so as to minimise the risks of uncertainty and unintended double taxation and to ensure the consistent and proper implementation of tax treaties.157 These measures were underpinned by a strong political commitment to the effective and timely resolution of disputes through MAP.

Under Action 14, countries agreed to a minimum standard with respect to the resolution of treaty-related disputes, which was complemented by a set of best practices. There was commitment for rapid and effective implementation through the establishment of a robust peer-based monitoring mechanism that would report regularly through the Committee on Fiscal Affairs to the G20. The minimum standard would:

• Ensure that treaty obligations related to the mutual agreement procedure were fully implemented in good faith and that MAP cases were resolved in a timely manner;

• Ensure the implementation of administrative processes that would promote the prevention and timely resolution of treaty-related disputes; and

• Ensure that taxpayers could access the MAP when eligible.

A disappointing aspect of the proposals was that there was no consensus on moving towards mandatory arbitration.158 Enhanced dispute resolution options such as administrative appeals, mediation and arbitration, as well as alternative means of preventing and resolving disputes and audits should also have been developed. Without such changes, there is a real prospect of a dramatic increase of disputes leading to double taxation.

So far, in addition to the commitment to implement this minimum standard, the following countries have declared their commitment to provide for mandatory binding MAP arbitration in their bilateral tax treaties: Australia, Austria, Belgium, Canada, France, Germany, Ireland, Italy, Japan, Luxembourg, the Netherlands, New Zealand, Norway, Poland, Slovenia, Spain, Sweden, Switzerland, the United Kingdom and the United States. This is thought to be a major step forward as together these countries were involved in more than 90 percent of outstanding MAP cases at the end of 2013, as reported to the OECD.159

The proposals are welcome though much would depend on how the recommendations are implemented in practice leading to widespread access to the MAP and effective dispute resolution. The degree of political commitment from all participating countries and especially those where the greatest improvements arguably need to be

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157 Action 14 of the BEPS Project reads as follows: *"Develop solutions to address obstacles that prevent countries from solving treaty-related disputes under MAP, including the absence of arbitration provisions in most treaties and the fact that access to MAP and arbitration may be denied in certain cases."*

158 Kristen A. Parillo, *"OECD Proposes Improvements to Treaty Dispute Resolution Process",* 2014 WTD 244-2 (22 December, 2014)

159 See www.oecd.org/ctp/dispute/map-statistics-2013.htm, cited in Executive Summary.

made (e.g. India, China, Brazil) are key to the successful implementation of these proposals.

What is undeniable is that BEPS will increase the issues under dispute, many of which are of high value. Also, the disputes are likely to be multinational and involve economic double taxation more than legal double taxation. For Action 14 to be successful, dispute resolution has to be swift and effective. Also, the rights of taxpayers to intervene in the dispute resolution process needs to be ensured. So far, these rights have not been explored.[160]

13. Develop a Multilateral Instrument: Action 15

In the executive summary of the Final Report[161] on Action 15, it was conceded that the current network was not well-synchronised with the model tax conventions, and issues that would arise over time could not be addressed swiftly. "Without a mechanism to swiftly implement them, changes to models only make the gap between the content of the models and the content of actual tax treaties wider. This clearly contradicts the political objective to strengthen the current system by putting an end to BEPS, in part by modifying the bilateral treaty network. Doing so is necessary not only to tackle BEPS, but also to ensure the sustainability of the consensual framework to eliminate double taxation."[162]

Action 15 of the BEPS Action Plan provided an analysis of the tax and public international law issues related to the development of a multilateral instrument to enable countries to implement BEPS measures and amend bilateral tax treaties. Interested countries were expected to develop a multilateral instrument to streamline the implementation of the tax treaty-related BEPS measures. These included tax treaty provisions on hybrid entities, dual-resident companies, and deductible dividends developed under Action 2, the anti-abuse provisions (including the minimum standard on treaty abuse) developed under Action 6, changes to address artificial avoidance of the permanent establishment (PE) definition under Action 7, and the provisions to improve dispute resolution under Action 14.

In addition, a number of countries have declared their commitment to provide for mandatory binding MAP arbitration as part of the negotiation of the multilateral instrument. A sub-group of interested countries is being set up to carry out the technical work in this respect.[163]

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160 Jacques Malherbe, *"The Issues of Dispute Resolution and Introduction of a Multilateral Treaty",* 43 [2015] 1 Intertax 91, 93

161 OECD (2015), Developing a Multilateral Instrument to Modify Bilateral Tax Treaties, Action 15 - 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris. Available at: http://dx.doi.org/10.1787/9789264241688-en

162 *Ibid*, Executive summary, p.9

163 Jesse Eggert & Evelyn Lio, "Action 15: Developing a multilateral instrument to modify bilateral tax treaties", International Tax Review. 1/4/2016, p17

In the Final Report, the 2014 discussion draft[164] was reproduced. This discussion draft had explored the technical feasibility of a multilateral hard law approach and its consequences on the current tax treaty system. It identified the issues arising from the development of such an instrument and provided an analysis of the international tax, public international law, and political issues that arise from such an approach.

The multilateral instrument was expected to affect over 3,000 bilateral agreements so it was important that there was clarity over how it would work. A mandate to set up an ad hoc Group for the development of a multilateral instrument was developed by the OECD Committee on Fiscal Affairs and endorsed by the G20 Finance Ministers and Central Bank Governors at their February 2015 meeting. The ad hoc Group was quickly established and work began in May 2015. The inaugural meeting of the ad hoc group was held in November 2015.The ad hoc Group now consists of 95 countries from OECD/G20 countries, developing countries and non-OECD/non-G20 economies, all participating in the work on an equal footing. Some international organisations are participating as observers.

Work is expected to continue throughout 2016 to conclude the multilateral instrument and open it for signature by December 2016. It is thought that the multilateral instrument will likely take just over a year for the changes to be introduced, subject to an agreement between states.

IV. The European Union's fights against aggressive tax planning: Developments pre- and post-BEPS

While some developments in the international tax arena were to an extent anticipated and long overdue, the developments in the EU are short of ground-breaking. Post-BEPS, the EU institutions are taking a very active and high-profile role in the fight against aggressive tax planning. In order to understand the recent developments, it is useful to briefly review some of the developments prior and during the consultations pursuant to the BEPS project.

1. Focusing on Double Non-Taxation

It is worth pointing out that in the pre-BEPS era, the emphasis was not so much on the prevention of international tax avoidance but rather on the prevention of overtly

164 OECD/G20 Base Erosion and Profit Shifting Project, "*Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS*". Available on: http://www.oecd.org/ctp/beps-action-15-mandate-for-development-of-multilateral-instrument.pdf

restrictive domestic anti-abuse rules which hindered the single market. There was no discussion on double non-taxation[165] or aggressive tax planning.

For example, the 2007 Commission Anti-Abuse Communication[166] on the application of anti-abuse measures placed emphasis on intentional tax abuse, though there was mention of adopting coordinating solutions in close cooperation with Member States so as to reduce potential mismatches resulting in inadvertent non-taxation. This Communication called for a more targeted and better coordinated application of these rules. There had to be a just balance between the public interest in tackling abuse and the need to avoid restrictions on cross-border activities within the EU.

The Commission went on to reiterate the principles under the case law which had arisen up to that point in time. The need to prevent tax avoidance or abuse[167] could constitute an overriding reason in the public interest capable of justifying a restriction on fundamental freedoms. The Commission added that the notion of tax avoidance is limited to "wholly artificial arrangements aimed at circumventing the application of the legislation of the [Member States] concerned".[168] In order to be lawful, national tax rules must be proportionate and serve the specific purpose of preventing wholly artificial arrangements.

What is notable (though unsurprising at the time) is that the emphasis of this Commission Communication was on tax abuse and the compatibility of anti-abuse measures with EU law. There was some recognition of the importance of anti-abuse measures for Member States, in protecting their tax bases, though this was rather a secondary matter. The Commission identified the need for a general review of Member State anti-avoidance rules.[169] It was important for Member States to improve the coordination of anti-abuse measures within Member States and in relation to third countries. Member States were encouraged to establish common definitions of the notions of abuse and purely artificial arrangements, to improve administrative cooperation to detect and neutralise fraudulent fiscal practices, to exchange best practices compatible with Community law and to reduce overlaps, which can result in unintended non-taxation.

Unintentional non-taxation was also mentioned earlier on in the Commission Anti-Abuse Communication, were it was noted that Member States need "to be able to operate effective tax systems and prevent their tax bases from being unduly eroded because of inadvertent non-taxation".[170] To an extent, this could be perceived as the

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165 See for example the IFA 2004 conference topic on double non-taxation for which there was no EU report. Similarly, there were very few references to EU law in the General Report. Double non-taxation was not an issue for the European Community at the time; rather measures to curb it were. See IFA Cahiers 2004 - Volume 89a, "Double non-taxation", General Report by Michael Lang.

166 Commission Communication of 10 December 2007 to the Council, the European Parliament and the European Economic and Social Committee entitled "The application of anti-abuse measures in the area of direct taxation - within the EU and in relation to third countries" (COM(2007) 785 final) (henceforth, Commission Anti-Abuse Communication)

167 Rather confusingly, in many places, the Commission used the terms tax avoidance and abuse as if they were synonymous, as far the analysis was concerned.

168 Commission Anti-Abuse Communication, p.3

169 *Ibid*, pp.8-9

170 *Ibid*, p.5

precursor of some of the actions subsequently taken at EU level not only to deal with tax abuse but also double non-taxation and later on aggressive tax planning.

2. Early Awakenings: The 2012 Action Plan

Since 2012, the EU institutions have been taking a much more active role in the fight against tax fraud and tax evasion. On 2 March 2012, the European Council called on the Council and the Commission to rapidly develop concrete ways to tackle this issue, including in relation to third countries and to report by June 2012. On 19 April of that same year, the European Parliament adopted a resolution echoing the urgent need for action in this area.[171]

Following this, on 27 June 2012, the Commission adopted a Communication on concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries.[172] This led to the Action Plan to Strengthen the Fight against Tax Fraud and Tax Evasion[173] which would seek to set out concrete steps to enhance administrative cooperation and to support the development of the existing good governance policy. The Action Plan, accompanied by two recommendations, was released in December 2012. By that time, the concept of aggressive tax planning was beginning to be firmly established and concerns about it widely shared in the international tax community.

The Commission Communication on the Action Plan contained practical actions which could deliver concrete results to all Member States.[174] Two recommendations were mentioned in the Communication. These were the Recommendation on measures intended to encourage third countries to apply minimum standards of good governance in tax matters (henceforth, the Recommendation on Good Governance)[175] and the Recommendation on Aggressive tax planning.[176] The Recommendations were published separately at the same time as the Communication but their essence was summarized in the Communication.

The Recommendation on Good Governance sought to provide Member States a set of criteria to identify third countries that did not meet minimum standards of good governance in tax matters and a 'toolbox' of measures in regard to third countries according to whether they comply with those standards, or are committed to complying with them. As far as the Recommendation on Aggressive Tax Planning

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171 European Parliament resolution of 19 April 2012 on the call for concrete ways to combat tax fraud and tax evasion (2012/2599(RSP))
172 Communication from the Commission to the European Parliament and the Council on concrete ways to reinforce the fight against tax fraud and tax evasion including in relation to third countries, COM (2012) 351 final of 27.06.2012
173 Communication from the Commission to the European Parliament and the Council, *An Action Plan to strengthen the fight against tax fraud and tax evasion*, COM(2012) 722 final of 6.12.2012
174 Action Plan, p.3
175 Commission Recommendation of 6.12.2012 regarding measures intended to encourage third countries to apply minimum standards of good governance in tax matters (C (2012) 8805 final)
176 Commission Recommendation of 6.12.2012 on Aggressive Tax Planning (C (2012) 8806 final)

was concerned, the Commission referred to complex and artificial tax planning leading to the relocation of the tax base to other jurisdictions within or outside the EU, as well as mismatches in national laws leading to double non-taxation and the exploitation of tax rates.

The Commission expressed its willingness to contribute to the work of international tax fora such as the OECD. Initiatives mentioned were, *inter alia,* the development of international standards to address the complexities of taxing electronic commerce, the creation of a Platform for Tax Good Governance, improvements in the area of harmful business taxation, promoting the Code of Conduct for business taxation in selected third countries, ensuring the Directives do not lead to double non-taxation, continuing to develop standard forms for exchange of information in the field of taxation etc.[177]

The remainder of the Communication set out specific measures to be taken in the short term,[178] medium term[179] and long term[180] to tackle the problems mentioned. This was the Commission's self-proclaimed "general contribution to the wider international debate on taxation and [which was] aimed at assisting the G20 and the G8 in its on-going work in this field".[181]

Following the publication of the Action Plan, the Commission has moved forward with several of the recommendations outlined.

On April 23, 2013, the Commission launched the Platform for Tax Good Governance, to discuss best practices in the fight against tax evasion, tax avoidance and tax havens.[182] This platform would monitor Member States' progress in tackling aggressive tax planning and clamping down on tax havens, in line with the aforementioned Recommendations.

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177 *Ibid*, pp.7-8

178 This would include, *inter alia,* the revision of the Parent-Subsidiary Directive and the anti-abuse provisions of the other Directives, promoting the standard of automatic exchange of information in international fora and the EU IT tools, a European Taxpayer's Code, reinforcing cooperation with other law enforcement bodies, promoting the use of simultaneous controls and the presence of foreign officials for audits, obtaining an authorisation from Council to start negotiations with third countries for bilateral agreements on administrative cooperation in the field of VAT etc. *Ibid*, pp.9-11

179 This would include the development of a computerised format for automatic exchange of information on income from employment, directors' fees, life insurance products, pensions and on ownership of and income from immovable property, pursuant to Art 8(1) of the Mutual Assistance Directive 2011/16/EU, the use of an EU Tax Identification Number (TIN), the development of guidelines for tracing money flows, extending EUROFISC (a system of rapid exchange of information on cases of fraud in the VAT area) to direct taxation, creating a one-stop-shop approach in all Member States, developing motivational incentives including voluntary disclosure programmes, a tax web portal, an EU Standard Audit File for Tax etc. *Ibid*, pp.11-14.

180 This would include a methodology for joint audits by dedicated teams of trained auditors, the development of mutual direct access to national databases, a single legal instrument for administrative cooperation for all taxes. *Ibid*, pp.14-15.

181 *Ibid*, p.15

182 Commission Decision of 23.4.2013 on setting up a Commission Expert Group to be known as the Platform for Tax Good Governance, Aggressive Tax Planning and Double Taxation, Brussels, 23.4.2013 (C(2013) 2236 final)

In June 2013, the new Accounting Directive[183] was enacted which introduced an obligation for large extractive and logging companies to report country-by-country the payments made to governments, and also on a project-basis. The obligation to publish the accounts is for tax years beginning on or after 1 January, 2016. There are several exemptions for small and medium sized enterprises.[184] Increased transparency is also manifest in the Extractive Industries Transparency Initiative.[185] The Revised Capital Requirements Directive[186] improved transparency in the activities of banks and investment funds in different countries, particularly regarding profits, taxes and subsidies in different jurisdictions.[187]

Following the momentum created by the OECD/G20 BEPS Action Plan and the EU's Action Plan, the Commission seized on the opportunity to amend several direct tax directives.[188] Some of the proposed amendments, such as those to the Savings Directive,[189] were long overdue.

On 25 November, 2013, the Commission made a proposal to amend the Parent-Subsidiary Directive to tackle hybrid loans and mismatches.[190] The proposal also required Member States to adopt a common general anti-abuse clause to prevent them from extending the benefits of the directive to arrangements that did not reflect economic reality. This would replace the existing anti-abuse provision found in Article 1(2) of the Directive.

At the ECOFIN meeting on 20 June, 2014, Member States finally reached an agreement but only on the hybrid element of the proposal. Article 4(1)(a) of the Directive would be amended to provide that where a parent company, by virtue of its association with its subsidiary, receives distributed profits, the Member State of the parent company shall refrain from taxing such profits to the extent that such profits are not deductible by the subsidiary of the parent company. Member States would have until 31 December 2015 to transpose the amendment into national law.

The common anti-abuse provision was approved later on at the ECOFIN meeting on 9 December, 2014. Broadly, this provision would allow Member States not to grant the

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183 Directive 2013/34/EU of the European Parliament and of the Council of 26 June 2013 on the annual financial statements, consolidated financial statements and related reports of certain types of undertakings, amending Directive 2006/43/EC of the European Parliament and of the Council and repealing Council Directives 78/660/EEC and 83/349/EEC Text with EEA relevance

184 See Articles 30-32 Directive 2013/34/EU

185 For more information, see http://eiti.org/

186 Directive 2013/36/EU of the European Parliament and of the Council of 26 June 2013 on access to the activity of credit institutions and the prudential supervision of credit institutions and investment firms, amending Directive 2002/87/EC and repealing Directives 2006/48/EC and 2006/49/EC Text with EEA relevance

187 For commentary, see Rudolf Reibel, *"Tax Transparency – How to Make it Work",* 55 (2015) 5 European Taxation 209-212

188 Measures have also been taken in the VAT field, where new instruments were introduced to better fight VAT fraud e.g. the Quick Reaction Mechanism and the Reverse Charge Mechanism. Also see Commission Proposal for a Council Directive amending Directive 2006/112/EC on the common system of value added tax as regards a standard VAT return, COM (2013) 721 of 23.10.13. See also the Implementation Plan (SWD/2013/ 428), the Impact Assessment (SWD/2013/427), its summary (SWD/2013/426). These measures and proposals are not considered further in this book.

189 See chapter 2 in HJI Panayi (2013), *fn. 68*

190 See IP/13/1149.

benefits of the Directive to "an arrangement or a series of arrangements that, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances".[191] Member States were entitled to continue applying their domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse.[192]

Whilst the amendment to the Parent-Subsidiary Directive was done under the pretext of furthering BEPS measures encapsulated under Action 2, there are, in reality, differences between the two anti-hybrid rules. It would seem that the Parent-Subsidiary Directive amendment *allows* the Member State of residence of the recipient not to exempt the profits received – it does not impose an obligation to do so.[193] Furthermore, there is no obligation on the Member State of source (i.e. the State of residence of the payor of profit distributions) to act in a certain way. Of course that Member State can use the common anti-abuse provision to take further punitive action, but it is within the discretion of either Member State to take any action at all.[194]

By contrast, the rules devised under Action 2, rely on action which is *required* to be taken by either jurisdiction in which the mismatch arises. The aim is for the mismatch to be neutralized by either jurisdiction. As a result of the primary and defensive rules which apply automatically and in a hierarchical manner, there is an obligation on *either* jurisdiction to take action. The amendment in the Directive relies on unilateral discretionary action, whereas the linking rules under Action 2 rely on bilateral obligatory action.

It could be argued that the anti-hybrid amendment of the Parent-Subsidiarity Directive ultimately aims to achieve a symmetrical treatment of intra-group profit distributions on a multilateral basis – it reflects an internationally agreed (i.e. by Member States) allocation of taxing rights, albeit unilaterally enforced. As such, it should be treated similarly to other tax treaty arrangements (on allocation of taxing rights) which have

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191 See Article 4(1)(a). An arrangement could comprise of more than one step or part – i.e. it can be a series of arrangements. Also an arrangement or a series of arrangements would be regarded as not genuine to the extent that it was not put into place for valid commercial reasons which reflect economic reality.

192 Art 1(2) would be replaced by the following:

"2. Member States shall not grant the benefits of this Directive to an arrangement or a series of arrangements that, having been put into place for the main purpose or one of the main purposes of obtaining a tax advantage which defeats the object or purpose of this Directive, are not genuine having regard to all relevant facts and circumstances. An arrangement may comprise more than one step or part.

3. For the purposes of paragraph 2, an arrangement or a series of arrangements shall be regarded as not genuine to the extent that they are not put into place for valid commercial reasons which reflect economic reality.

4. This Directive shall not preclude the application of domestic or agreement-based provisions required for the prevention of tax evasion, tax fraud or abuse."

See No. doc.: 16435/14 FISC 221 ECOFIN 1157. For commentary, see Luc De Broe, *"At Last, Some Output on the Fight against Double Non-Taxation"*, (2014) 6 EC Tax Review 310-312.

193 For contrary view, see Evgenia Kokolia and Evgenia Chatziioakeimidou, "*BEPS Impact on EU Law: Hybrid Payments and Abusive Tax Behaviour"*, [2015] 4 European Taxation 149-156; Filip Debelva & Juris Luts, *"The General Anti-Abuse Rule of the Parent-Subsidiary Directive"*, 55 [2015] 6 European Taxation 223-234

194 See HJI Panayi (2015), *fn*.35, chapter 5

been tolerated by the Court of Justice.[195] By contrast, the OECD hybrid rules, unless incorporated in the multilateral agreement suggested under Action 15 of the BEPS project, are likely to be presented as a single-country response to hybrid mismatches and not as part of a bilateral/multilateral treaty arrangement. In other words, the OECD hybrid rules may be a different species of rules than those derived under a tax treaty arrangement or a Directive, which would not necessarily be protected the same way under EU tax law. Therefore, adoption of the anti-hybrid rule in the Parent-Subsidiary Directive does not mean that the OECD's linking rules would be similarly welcome and, most importantly, compatible under EU law.

In any case, as a result of the impetus, the Savings Directive was also finally adopted and later on abolished altogether,[196] being superseded by the amendments to the Mutual Assistance Directive 2011/16/EU which Member States agreed to at the ECOFIN meeting in October 2014.[197] The Mutual Assistance Directive was to be repealed again following a legislative proposal for the automatic exchange of information on tax rulings.[198] This proposal was in the context of the Tax Transparency Package, produced by the European Commission in February-March 2015,[199] under the auspices of a new president, Jean-Claude Juncker, poised to prove

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195 See chapters 5 and 6 of HJI Panayi (2015), *fn*.35

196 A proposal to amend the Savings Directive was made in 2008, but there was no consensus to adopt it. Proposal for Council Directive amending Directive 2003/48/EC on taxation of savings income in the form of interest payments: COM(2008) 727 final. This proposal was again discussed in the ECOFIN Council on 14–15 February 2011. See also Council of the European Union, 6514/11, Provisional Version, PR CO 6, 3067th Council meeting, ECOFIN, Brussels, 15 February 2011. Reported at 2011 WTD 33-16. Notwithstanding Member States' reluctance to amend the Savings Directive, the Commission continued with its mandate to re-negotiate stronger savings tax agreements with Switzerland, Andorra, Monaco, San Marino and Liechtenstein. The main purpose of re-negotiating these agreements was to ensure the continued equivalence of the measures applied by these countries with those applied internally within the EU. See MEMO/12/353. On 24 March, 2014 the EU Council of Ministers finally adopted the revised version of the Savings Directive. Official Journal L 155 of 15 April 2014, p.50. Changes were made to close existing loopholes and better prevent tax evasion. *Inter alia,* a look-through approach based on 'customer due diligence' was implemented which would have prevented individuals from circumventing the Directive by using an interposed legal person (e.g. foundation) or arrangements (e.g. trust) situated in a non-EU country which does not ensure effective taxation. The provisions of the Savings Directive were also refined to ensure that individuals would not circumvent the Directive by using an interposed legal person situated in an EU Member State. National rules transposing the revised Savings Directive should be adopted by Member States by January 2016.

197 In this important meeting, Member States agreed on a Commission proposal to apply the widest possible scope of automatic exchange of information within the EU, to mirror the global standard of automatic information exchange agreed by the G20. It was agreed that from 2017, Member State tax authorities would automatically exchange information with each other on most categories of income and capital held by private individuals and certain entities. Austria was to be given an additional year to apply the new rules, so as to have sufficient time to make the necessary technical adaptations. The revised Mutual Assistance Directive would cover a wide scope of income and capital.

198 See Press Release on 18 February 2015, IP/15/4436 available on: http://europa.eu/rapid/press-release_IP-15-4436_en.htm

199 The Tax Transparency Package was to be based on the Commission's commitment in its Work Programme in December 2014 to clamp down on tax evasion and tax avoidance and to ensure that taxes were paid in the country where profits are generated. See Press Release on 16 December 2014, IP/14/2703 available on: http://europa.eu/rapid/press-release_IP-14-2703_en.htm. Among the 23 initiatives see the initiative entitled 'A Fairer Approach to Taxation' which sets out the following: "*An Action Plan on efforts to combat tax evasion and tax fraud, including measures at EU level in order to move to a system on the basis of which the country where profits are generated is also the country of taxation; including automatic exchange of information on tax rulings and stabilising corporate tax bases*."

to the world that he is tough on tax avoidance and that he is seeking to instil "some morality, some ethics, into the European tax landscape."[200]

The problem with tax rulings is that Member States shared very little information with one another about their tax rulings and it was at their discretion to decide whether a tax ruling might be relevant to another EU country.[201] As a result, Member States were often unaware of cross-border tax rulings issued elsewhere in the EU which may impact their own tax bases. This lack of transparency was exploited by certain companies in order to artificially reduce their tax contribution.[202] In order to address this situation, the Commission proposed new provisions on exchange of tax rulings to be built into the existing legislative framework for information exchange, through amendments to the Mutual Assistance Directive.[203] Member States would be required automatically to exchange information on their tax rulings. Every three months, national tax authorities would have to send a short report to all other Member States on all cross-border tax rulings and advance pricing agreements[204] that they have issued after the date of entry into force of the suggested Directive, including those that were issued during the last 10 years but remained valid on 1 January 2016. Member States would then be able to ask for more detailed information on a particular ruling. This would enable the rapid implementation of automatic exchange of information on tax rulings, as the procedures and processes to do so were already in place.

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200 See speech in Brussels, in July 2014, reported by several media outlets. See, e.g. http://www.theguardian.com/business/2014/nov/05/-sp-luxembourg-tax-files-tax-avoidance-industrial-scale Ironically, Jean-Paul Juncker was the Prime Minister of Luxembourg at a time that aggressive tax planning practices thrived, as exposed by the Luxembourg Leaks. Following the Luxembourg leaks, Juncker was embroiled in political controversy but still survived a vote of confidence in the European Parliament in November 2014. See HJI Panayi (2015), *fn.*35, chapters 1 and 9.

201 Under the Mutual Assistance Directive 2011/16/EU as applied at the time, information on tax rulings could be exchanged on a spontaneous basis under very limited circumstances.201 The Member State granting the tax ruling was, however, the only one to decide whether, and for whom, this information may be relevant. Moreover, it could refuse to spontaneously exchange information on the basis of its commercial secrecy laws or public policy. See Art 9(1) of Mutual Assistance Directive 2011/16/EU, which set out the scope and conditions of spontaneous exchange of information.

202 See also Communication from the Commission to the European Parliament and the Council on tax transparency to fight tax evasion and avoidance, COM(2015) 136 final (Brussels, 18.3.2015), p.4

203 See Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, SWD(2015) 60 final, COM(2015) 135 final, 2015/0068 (CNS) Brussels, 18.3.2015. The proposed Directive would also update the rules in the existing Directive concerning the provision of feedback, the practical arrangements for information exchange and the evaluation of administrative cooperation so as to extend them to the automatic information exchange on advance cross-border rulings and advance pricing arrangements.

204 Under paragraph 5 of the initially proposed Art 8a of the Directive (Scope and conditions of mandatory automatic exchange of information on advance cross-border rulings and advance pricing arrangements), the information to be communicated shall, as a minimum, include the following: (a) the identification of the taxpayer and where appropriate the group of companies to which it belongs; (b) the content of the advance cross-border ruling or advance pricing arrangement, including a description of the relevant business activities or transactions or series of transactions; (c) the description of the set of criteria used for the determination of the transfer pricing or transfer price itself in the case of an advance pricing arrangement; (d) the identification of the other Member States likely to be directly or indirectly concerned by the advance cross-border ruling or advance pricing arrangement; (e) the identification of any person, other than a natural person, in the other Member States likely to be directly or indirectly affected by the advance cross-border ruling or advance pricing arrangement.

In its Communication accompanying the proposals of the Tax Transparency Package, the Commission argued that this initiative would encourage healthier tax competition, as tax authorities would be less likely to offer selective tax treatment to companies if this was open to scrutiny by their peers.[205] The automatic exchange of information on tax rulings would enable Member States to detect certain abusive tax practices by companies and take the necessary action in response.

On 6 October 2015, the Commission announced that Member States had reached an agreement on the automatic exchange of tax rulings,[206] with some amendments to the initial proposal.[207]

3. The European Commission Ups its Game: The 2015 Action Plan and Anti-Tax Avoidance Package

The Action Plan on A Fair and Efficient Corporate Tax System was released in June 2015 as a Commission Communication.[208] This Action Plan was intended to improve the corporate tax environment in the EU, making it fairer, more efficient and more growth-friendly. The key actions included a strategy to re-launch the Common Consolidated Corporate Tax Base (CCCTB) and a framework for effective taxation where profits were generated. The Commission also published a first pan-EU list of third-country non-cooperative tax jurisdictions and was launching a public consultation to assess whether companies must publicly disclose certain tax information.

The objectives of the Action Plan were the following. Firstly, there should be a re-establishment of the link between taxation and where economic activity takes place. Secondly, Member States should ensure that they can correctly value corporate activity in their jurisdiction. Thirdly, a competitive and growth-friendly corporate tax

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205 Communication from the Commission to the European Parliament and the Council on tax transparency to fight tax evasion and avoidance, COM(2015) 136 final (Brussels, 18.3.2015), p.4
206 See Press Release dated 6 October 2015, available on: http://europa.eu/rapid/press-release_IP-15-5780_en.htm
207 E.g. the initial proposal would have required EU Member States to automatically exchange information on cross-border tax rulings and APAs that were issued over the last 10 years on a quarterly basis. The revised proposal reduces the retroactive period to five years. Advance cross-border rulings and APAs issued, amended or renewed after 31 December 2011 would now fall within the scope of new rules, provided that advance rulings or APAs are still valid on 1 January 2017. Rulings that are no longer valid on 1 January 2017 would also fall within the scope of new rules, provided they are issued, amended or renewed after 31 December 2013. Rulings and APAs concerning SMEs that meet a group-wide annual net turnover of a maximum of €40 million do not have to be exchanged if issued, amended or renewed before 1 April 2016. The exemption does not apply to companies conducting mainly financial or investment activities. There is some protection of trade secrets. The information to be disclosed would include a summary of the ruling, including a description of the relevant business activities or transactions, but exclude the disclosure of a commercial, industrial or professional secret or of a commercial process, or of information whose disclosure would be contrary to public policy.
208 Communication from the Commission to the European Parliament and the Council, 'A Fair and Efficient Corporate Tax System in the European Union: 5 Key Areas for Action' COM(2015) 302 final, 17 June 2015.

environment should be created for the EU. Fourthly, the single market should be protected and a strong EU approach on corporate tax issues should be secured. This should include the implementation of OECD BEPS deliverables, dealing with non-cooperative tax jurisdictions and increasing tax transparency.[209]

The Commission identified five key areas for action.

Firstly, there should be a relaunch of the CCCTB. It was stated that a new legislative proposal for a *mandatory* CCCTB at least for MNEs would be presented in 2016. There would be implementation in two stages. Firstly, there would be a common tax base (CCTB). Due to the difficulties of agreeing on consolidation, the Commission proposed that work on consolidation would be postponed until after the common base had been agreed and implemented. Consolidation would follow at a later stage. If unanimity is not achieved, it is possible that a CCTB could proceed for selected Member States under enhanced cooperation.[210]

The second area of action was to ensure effective taxation where profits are generated, as such, echoing discussions at international level in the context of the OECD BEPS project. Taxation should be brought closer to where profits are generated, to ensure effective taxation of profits. It was argued that a fully-fledged CCCTB would make a major difference in reinforcing the link between taxation and where profits are generated. Consensus on aspects of the common base which were linked to BEPS, such as adjusting the definition of a permanent establishment and improving CFC rules, should be achieved within 12 months and made legally binding before an agreement is reached on the revised CCCTB. Other measures include amending the Interest and Royalties Directive so that benefits will not be granted to interest and royalty payments unless they are effectively taxed elsewhere in the EU. As a second step, the Parent/Subsidiary Directive would be aligned with the Interest and Royalties Directive.

The Commission would also build on BEPS transfer pricing recommendations and develop coordinated and more concrete implementation within the EU, reflecting the economic reality of the Single Market:

> 'For example, recent OECD and EU proposals aiming at increasing transparency will provide new information which could help tax administrations identify intragroup transactions which require further investigation. The Commission could provide guidance and propose specific tools on how this information could be best used by tax administrations.'

Furthermore, efforts would also be made to link preferential regimes to where value is generated. The Commission would continue to provide guidance to Member States on how to implement patent box regimes in line with the new approach (the modified nexus approach) so as to ensure that they are not harmful, and will carefully monitor this implementation. If, within 12 months, the Commission found that Member States

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209 *Ibid*, p. 6
210 *Ibid*, pp. 7 and 8

were not applying this new approach consistently, it would prepare binding legislative measures to ensure its proper implementation.[211]

Additional measures were suggested for a better tax environment for business – this was the third key area of action. For example, temporary cross-border loss relief would be introduced in advance of a full CCCTB.[212] To ensure that one Member State does not definitively carry the burden of losses incurred in another Member State, there would be a mechanism to recapture these losses once the group entity was profit-making again. The Commission planned to include this initiative as one of the stages in its revised proposal on the CCCTB.

The Commission would also propose improvements to current mechanisms to resolve double tax disputes in the EU. A coordinated EU approach to dispute resolution, with clearer rules and more stringent timelines would be beneficial. The Commission would review whether the scope of the Arbitration Convention should be extended within the Union and whether turning it into an EU instrument (i.e. Regulation or Directive) would be more efficient. It was recognised that the common base in the CCCTB proposal would eliminate the risk of double taxation in the EU.[213]

Several measures were also discussed to promote tax transparency, which constituted the fourth key area of action. Accompanying this Communication, the Commission has published an EU 'blacklist' of 30 non-EU tax jurisdictions. This would be updated periodically and used to develop a common EU strategy to deal with them as a second stage, via coordinated counter measures.[214] The Commission also launched a public consultation on whether all MNEs should have to publicly disclose certain tax information, including CBCR.[215]

As a fifth area of action, the EU tools for coordination should be improved. Better coordination of tax audits was essential. The Commission would launch a discussion with Member States to find a more strategic approach to controlling and auditing cross-border companies, including joint tax audits.[216] The Commission would also make proposals to reform the Code of Conduct for Business Taxation and the Platform on Tax Good Governance. By improve the functioning of the Code of Conduct this would enable the Code of Conduct for Business Taxation Group to react more efficiently to cases of harmful tax competition.[217] The Commission would also prolong the mandate, extend the scope and enhance working methods of the Platform to help deliver the Action Plan, facilitate discussions on tax rulings in the light of the proposed new information exchange rules, and provide feedback on new anti-avoidance initiatives.[218]

On 9 September 2015, at his state of the Union address, the Commission President, Jean-Claude Juncker, repeated that the Commission is working on a common

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211 *Ibid*, p 10.
212 *Ibid*, p 11
213 *Ibid*, pp 11 and 12
214 *Ibid*, pp 12 and 13
215 *Ibid*, p 13
216 *Ibid*, p 14
217 *Ibid*.
218 *Ibid*.

consolidated corporate tax base and an agreement on the automatic exchange of tax ruling information and is investigating national tax schemes as part of its effort to enhance fairness in tax policy.[219]

In January 2016, the Commission presented its Anti-Tax Avoidance Package (ATAP), which is part of the Commission's ambitious agenda for fairer, simpler and more effective corporate taxation in the EU. The ATAP consisted of 7 parts: a proposed Anti-Tax Avoidance Directive; a Recommendation on the implementation of G20/OECD BEPS recommendations on tax treaty abuse and on permanent establishments (PEs); a proposed amendment to Directive 2011/16/EU on mandatory automatic exchange of information to enable coordinated implementation of the BEPS country-by-country reporting requirements; a general policy Communication on the ATAP and proposed way forward; a general policy Communication on an EU external strategy for effective taxation; a Commission Staff Working Document; and a Study on Aggressive Tax Planning.

In the draft Anti-Tax Avoidance Directive, the Commission addressed 6 international and BEPS-related elements.[220] The draft Anti-Tax Avoidance Directive proposed action in three areas covered by the BEPS proposals; namely, hybrid mismatches, interest restrictions (Action 4); and CFCs. However, the directive also proposed actions in three areas not reflected in the BEPS action plan; namely, a general-anti-abuse rule, switch over clauses and exit taxation.

In the Recommendation on implementation of measures to tackle tax treaty abuse,[221] Member States were urged to implement the OECD BEPS proposals to address tax treaty abuse. Where Member States include in tax treaties a GAAR based on a principal purpose test (PPT) as suggested in the OECD's final report on BEPS Action 6 (Prevention of Treaty Abuse), the Commission recommended that the rule should be modified to comply with EU case law such that genuine economic activity was not affected.

The Commission was again proposing to amend the Mutual Assistance Directive 2011/16/EU to ensure adoption of BEPS Action 13 country-by-country reporting requirements by extending the scope of the Directive.[222] The proposed amendment is expected to be approved soon and become effective on 1 January 2017. Indeed, it was approved at the ECOFIN meeting of 25 May 2016, as explained below.

In the general policy Communication, the Commission explained the rationale behind the ATAP.[223] There is endorsement of the BEPS project but at the same time, stipulation that the EU can and should go further to ensure that Member States develop a common standard and level-playing field by implementing the ATAP in a coordinated manner.

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219 SPEECH/15/5614

220 Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market, COM/2016/026 final - 2016/011 (CNS)

221 C(2016) 271 final

222 Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, COM/2016/025 final - 2016/010 (CNS)

223 Commission Communication on the Anti-Tax Avoidance Package: Next steps towards delivering effective taxation and greater tax transparency in the EU, COM/2016/023 final

In the Communication on an EU external strategy for effective taxation, the Commission discussed ideas to promote tax good governance with non-EU countries, for example through a special clause in trade agreements with third countries.[224] The Commission also announced its intention to develop a screening process to assess and list third countries on the basis of their adherence (or lack of) to basic indicators of tax good governance. An update of the controversial June 2015 list of non-EU country non-cooperative tax jurisdictions was published online in an interactive map.[225]

In the context of the ATAP, the Commission published a new study on aggressive tax planning which it commissioned in order to identify indicators which facilitate such tax planning.[226] In the study, there was a review of corporate income tax systems of Member States against certain indicators, in order to identify tax rules and practices that result in Member States being vulnerable to aggressive tax planning.

Lastly, a Staff Working Document accompanied the ATAP.[227] The annex of this document included an overview of the BEPS Action Plan and corresponding EU actions.

It has recently been reported that the European Parliament's Economic and Monetary Affairs (ECON) Committee passed the Commission's proposal for the Anti-Tax Avoidance Directive, clearing the way for a vote by the Economic and Financial Affairs Council. This was done with more abstentions than votes in favour of the measure.[228]

Notwithstanding the strong determination of the Dutch Presidency (for the first half of 2016), the Commission and certain Member States, especially France and Germany, to adopt this directive, at the ECOFIN meeting of 25 May 2016, no agreement was concluded. The matter was postponed until the next ECOFIN meeting.

The ECOFIN meeting was presented with both a Presidency compromise text on the draft directive[229] and a proposal for a general approach.[230] The aim of the meeting was to at least settle on a general approach. Whilst there was strong agreement on the

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224 Commission Communication on an External Strategy for Effective Taxation, COM/2016/024 final
225 See map, available on: http://ec.europa.eu/taxation_customs/taxation/gen_info/good_governance_matters/lists_of_countries/index_en.htm
226 See Taxation paper No 61: Study on Structures of Aggressive Tax Planning and Indicators. Final report
227 Commission Staff Working Document, *Accompanying the document Communication from the Commission to the European Parliament and the Council – Anti Tax Avoidance Package: Next Steps towards delivering effective taxation and greater tax transparency in the EU*, SWD/2016/06 final
228 J. P. Finet, "*ECON Committee Passes Proposed EU Antiavoidance Directive*", reported on Tax Analysts on 25 May 2016 (2016 WTD 101-1)
229 Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market - Presidency compromise, 2016/0011 (CNS). Available on: http://www.consilium.europa.eu/register/en/content/out/?&typ=ENTRY&i=ADV&DOC_ID=ST-9431-2016-INIT
230 Proposal for a Council Directive laying down rules against tax avoidance practices that directly affect the functioning of the internal market - General approach, 2016/0011 (CNS). Available on: http://www.consilium.europa.eu/register/en/content/out/?&typ=ENTRY&i=ADV&DOC_ID=ST-9432-2016-INIT

need to combat aggressive tax planning at EU level, several Member States were concerned over the Presidency's compromise proposal. Therefore, a final agreement was not reached.[231] The January 2016 proposal to amend the Mutual Assistance Directive as regards mandatory automatic exchange of information in the field of taxation was adopted without discussion.

Overall, it seems undeniable that the EU is living up to its pledge of tackling tax evasion and aggressive tax planning. Whether the measures on enhanced transparency will improve Member States' capacity to address harmful tax practices and profit shifting beyond EU borders, without having a detrimental impact on the international competitiveness of EU companies remains to be seen.

There is obviously an appetite within the EU to tighten the EU corporate tax rules against aggressive tax planning. Without doubt, there is a hurry to benefit from the political momentum. The Commission has fast-tracked many legislative proposals or amendments at Council level, which the author has argued elsewhere,[232] are questionable from an EU compatibility perspective. It has also launched state aid investigations on tax rulings enjoyed by several high-profile MNEs, which are again dubious from a pure state aid perspective.[233] There certainly needs to be coordination with the principles set out by the Court of Justice in established case law, otherwise legal certainty is being jeopardised.

One should question whether in the absence of harmonization the European Union is currently going too far by restricting options for tax competition. Nevertheless, an EU strategy focusing only on the fight against tax avoidance and aggressive tax planning runs the risk of hindering the single market and reducing its efficiency and potential.[234] In the absence of a single *fiscal* market, such an *ad hoc* strategy can only do more damage than good in the long term.

V. International Tax Law in the Post-BEPS world

In light of the above developments internationally, how is the international tax system shaping up in the post-BEPS world? In answering this question, one needs to bear in mind that it is perhaps too soon to give a definitive answer, being less than a year

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[231] As has been reported, there were disagreements related to the scope of the hybrid mismatch rules, whether the switch-over rules should form part of the directive, and whether the effective taxation requirements in the proposal infringed Member States' tax autonomy, especially the right to set their own level of taxation. Concern was also expressed with respect to the CFC rules and whether they should apply both inside and outside the EU, the substance requirement, and where the burden of proof for substance should be placed. See KPMG Euro Tax Flash, available on: https://home.kpmg.com/xx/en/home/insights/2016/05/etf-285-no-agreement-on-draft-anti-avoidance-directive.html

[232] See HJI Panayi (2015), *fn.*35, chapter 6. Also, see Christiana HJI Panayi, *"The Compatibility of the OECD/G20 Base Erosion and Profit Shifting Proposals with EU Law"*, 70 [2016] 1/2 Bulletin for International Taxation pp.95-112.

[233] See HJI Panayi (2015), *fn.*35, chapter 7

[234] Michel Aujean, *"Plea for a New Tax Package",* [2015] 2 EC Tax Review 60-62, 61

since the publication of the final BEPS reports. However, some overall themes and trends seem to be emerging, which can help decipher a prognosis. These issues are considered in the remainder of this paper.

1. A Break from Tradition?

It was questioned at the launch of the BEPS project[235] whether this will be the starting point for the development of new principles of international tax law or whether it will be the final failure of the OECD to gain consensus on topics, notwithstanding the unprecedented level of political support. Whilst it was initially argued that BEPS was a political commitment of the OECD and the G20 countries, mostly a commitment to the agenda and "not a commitment to accept whatever solutions come out of the process",[236] the aftermath of this process could suggest otherwise.

As expected, it was very difficult to reach consensus on solutions to some problems and it was thought that uniform solutions might not be implemented by all countries. The need for coordination, however, remained crucial. Unless coordinated action had been taken at international level, countries would adopt (or would continue adopting) unilateral measures – hence why the strong initial support for the BEPS project by many countries.

The recommendations produced in the final reports reflect the difficulties of reaching consensus and the yearning for some *de minimis* coordination. What is noteworthy is that in the BEPS project, there is a break from tradition in the way that the proposals are presented. Instead of the OECD recommending model rules as consensus-built and definitive standards, in most discussion drafts (and the subsequent final reports) there is a menu of options that countries may select - a series of alternative or minimum requirements. The level of support for these various options among OECD/G20 countries is not fully measured yet. This is arguably attributable to the fact that the BEPS project is different from past OECD initiatives because it is not just driven by OECD countries but also non-member G20 countries.

Therefore, it is not just the final output that was non-traditional but the overall BEPS process, being spearheaded by the G20, which comprises of many more countries than the ones traditionally leading the way with OECD initiatives. Furthermore, developing countries were strongly encouraged to participate in the process and have done so to an extent. The OECD made an effort to engage with developing countries during the BEPS project.[237] Over 80 developing countries and other non-OECD/non-G20 economies were consulted and several memoranda of understanding (MOUs) were signed with international and regional organisations.[238] In addition to including

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235 Philip Baker, *"Is there a Cure for BEPS?"* (2013) 5 British Tax Review 605
236 *Ibid*, p.605
237 See www.oecd.org/tax/beps-about.htm
238 An MOU was signed between the Centre de rencontres et d'études des dirigeants des administrations fiscales (CREDAF) and the OECD on 16 March. CREDAF joined the African Tax

developing countries in the consultation and decision-making process, the OECD also published a number of papers on topics directly affecting developing countries. [239]

For the BEPS project to succeed, it was crucial for the proposed solutions to be relevant to, and effective for, developing countries. The OECD had promised to strengthen the way it engages with developing countries. The OECD and other organisations (IMF, UN, World Bank and regional organisations) were encouraged to develop practical toolkits to help developing countries implement key BEPS actions, without creating separate or alternative norms or standards.240

In early 2016, the OECD invited all interested countries to a more inclusive framework for international tax reform.241 It was announced that the OECD was working on a new framework that would allow all interested countries and jurisdictions to "join in efforts to update international tax rules for the 21st Century"242 – basically, to implement the BEPS project. This new forum would allow all interested countries and jurisdictions to participate in the discussions as BEPS Associates. As BEPS Associates, these countries would work on an equal footing with OECD and G20 members on the remaining standard-setting under the BEPS project, as well as the review and monitoring of the implementation of the BEPS package. The multilateral instrument, as envisaged by Action 15 of the BEPS Action Plan, might prove to be an important tool for this endeavour.

2. Organic refinement and (not) going back to basics?

A review of the rules at play in the current international tax system has been long overdue. The arbitrary allocation of taxing rights, relying on a source/residence dichotomy and an active/passive income distinction first agreed in the 1920s by the League of Nations, eventually encapsulated in the OECD Model243 has been gravely

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Administration Forum (ATAF) and the Center for Inter-American Tax Administrators (CIAT) which already have MOUs with the OECD aimed at strengthening the partnership to improve tax policy, and helping build greater capacity within the respective regions. See report in Tax Analysts, *'OECD Global Forum Welcomes Participation by Developing Countries*', 2015 *WTD* 57-14 (24 March 2015).

239 See OECD Public Consultation, *Transfer Pricing Comparability Data and Developing Countries* (2014). Available on: www.oecd.org/ctp/transfer-pricing/transfer-pricing-comparability-data-developing-countries.pdf

Also see Parts 1 and 2 of *A Report to G20 Development Working Group on the Impact of BEPS in Low Income Countries*, published in July 2014 and August 2014 respectively. Available on: www.oecd.org/ctp/tax-global/part-1-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf and www.oecd.org/g20/topics/taxation/part-2-of-report-to-g20-dwg-on-the-impact-of-beps-in-low-income-countries.pdf. See also OECD strategy for deepening the engagement of developing countries, available on www.oecd.org/tax/strategy-deepening-developing-country-engagement.pdf

240 HJI Panayi (2015) chapter 4

241 http://www.oecd.org/ctp/all-interested-countries-and-jurisdictions-to-be-invited-to-join-global-efforts-led-by-the-oecd-and-g20-to-close-international-tax-loopholes.htm

242 *Ibid*

243 See Chapter 1 in Christiana HJI Panayi, *Double Taxation, Tax Treaties, Treaty Shopping and the European Community*, Kluwer Law International 2007

manipulated over the years. It also proved to be ill-suited to deal with MNEs operating in today's global business environment. As noted, "the system is manipulable, distortive, often incoherent and unprincipled and encourages countries to compete with each other".244

However, even at the launch of the BEPS project, a consideration of the source/residence taxation question was excluded. It was widely thought back then that rather disappointingly, the BEPS project would not go back to basics in attempting to improve the international tax regime and this would be a futile project. Nevertheless, a cursory review of the final BEPS recommendations, whatever their degree of 'softness', suggests that the OECD *did* address some fundamental issues and valiant efforts were made to update the current tax system, in the context of a complex political environment which strove for consensus rather than perfect solutions. Furthermore, some of the discussions and concerns that were raised in the context of the BEPS Action items were taken over by other fora, some of which promised to give (or have already given) more assertive solutions, in the spirit of tackling aggressive tax planning.

For example, to an extent, Action 1 tries – very imperfectly, as suggested above - to deal with the allocation of taxing rights in the context of digital economy. This has implications for the source/residence questions. The point is more pronounced in the context of the recommendations produced by the EU's High-Level Expert Group on Taxation of the Digital Economy which was appointed in 2013 to examine taxation issues linked to the digital economy. This Digital Economy Group was asked to identify key problems and solutions, as well as improvements in the current way of taxing the digital economy in the EU, in order to enable the European Commission to develop an appropriate tax framework.

In a report published on 28 May 2014, the EU Digital Economy Report,245 the Group on Digital Economy reached a number of important conclusions. First, it noted that special rules for the digital economy were not needed. Rather, the general rules should be applied or adapted so that digital companies were treated in the same way as others. The role of digitisation in lowering the costs for small and medium-sized enterprises to access the internal market was considered. The importance of having simple and predictable rules to promote increased growth was emphasised.

By contrast to the OECD's deliverables on Action 1 which made no recommendations, here there was general consensus on the destination principle – i.e. *taxation at the place of consumption*. This would apply to all goods and services. The Group on Digital Economy suggested that the EU Mini One Stop Shop (MOSS)246

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244 Michael P. Devereux and John Vella, *"Are we Heading Towards a Corporate Tax System Fit for the 21st Century?"*, 35 [2014] 4 Fiscal Studies 449-475, p.461

245 *Report of the Commission Expert Group on Taxation of the Digital Economy*, 28.05.2014, p 5. Available on: http://ec.europa.eu/taxation_customs/resources/documents/taxation/gen_info/good_governance_matters/digital/report_digital_economy.pdf

246 Under the MOSS, from 1 January 2015, businesses are able to register and pay VAT for the supply of these services to non-taxable persons in their country of residence. Rather than registering in each Member State of consumption, businesses would account for VAT via a web portal of one Member State only. See 'Guide to the VAT Mini One Stop Shop', published by the Commission on 23 October 2013, available on:

which covered business-to-consumer sales of telecommunications, television/radio broadcasting and electronic services should be expanded into a broad One Stop Shop (OSS) to cover all business-to-consumer transactions. It appears that the Group on Digital Economy views the successful introduction of MOSS as a precursor to the adoption of OSS.[247] This will certainly have an impact on the use of source/residence for the purposes of allocation of taxing rights in the sphere of digital economy at the very least.

The Action items dealing with anti-abuse rules, Actions 2 to 4, mostly offer guidance in the form of best practices or menu of options. In fact, most of the discussion drafts were not consensus documents. Arguably, this is the result of the shifting focus of the OECD. Traditionally the OECD Model was about promoting trade and preventing double taxation. Now there was to be emphasis on protecting tax bases and fighting stateless income. Nevertheless, many countries across the world are in the process of enacting legislation adopting (some of) these recommendations or variations of them.

As discussed in Part IV, in the European Union, the Parent-Subsidiary Directive was amended to address some of the concerns raised under Action 2. Further proposals were recently made in the context of the draft Anti-Tax Avoidance Tax Directive which would *inter alia* adopt the recommendations on Actions 2 to 4, in what the Commission considers to be their EU-compatible version.

Perhaps the biggest cross-over is in the context of Action 5 – the modified nexus approach for patent boxes and the compulsory spontaneous exchange of taxpayer-specific rulings related to preferential regimes. Under BEPS, this is to be one of the minimum standards to which countries make a political commitment. The modified nexus approach was largely anticipated, at least among EU Member States, given the hostility shown towards the UK patent box regime and similar types of regimes. This is an issue that the EU Code of Conduct Group has been examining for some time.248 On 10 December, 2013 the Group had been asked by ECOFIN to assess all patent boxes in the EU, taking into account international developments. On 9 December,

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http://ec.europa.eu/taxation_customs/resources/documents/taxation/vat/how_vat_works/telecom/one-stop-shop-guidelines_en.pdf
This scheme is optional and it is a simplification measure following the change to the VAT place of supply rules, in that the supply takes place in the Member State of the customer and not the Member State of the supplier. MOSS mirrors the scheme in place until 2015 for supplies of electronically supplied services to non-taxable persons by suppliers not established in the EU. There is no registration threshold. This has been criticised and is likely to change. For commentary, see Paolo Centore and Maria Teresa Sutich, 'Taxation and Digital Economy: Europe is Ready' (2014) *Intertax* 784–87; Matthew Dubin, 'The EU Digital Service VAT Change and the Potential Effects on Suppliers and their Customers' (2015) 78 *Tax Notes International* 535 (9 Feb 2015); Patrick Wille, 'New Rules from 2015 Onwards for Telecommunications, Radio and Television Broadcasting, and Electronically Supplied Services' (2015) 26 *International VAT Monitor* 6–8; Marie Lamensch, 'The 2015 Rules for Electronically Supplied Services – Compliance Issues' (2015) 26 *International VAT Monitor* 11–16; Rick Minor, 'The EU's Emerging Digital Single Market' (2015) 78 *Tax Notes International* 599 (18 May 2015).

247 See David D Stewart, 'Digital Economy Raises Need for Simplified Tax Regimes, EU Report Says' Tax Analysts 2014 *WTD* 103-2 (29 May 2014). Also see Rick Minor, 'A Practical Perspective on the EU Digital Economy Expert Group's Proposals for VAT on Electronic Services', Tax Analysts, 2014 *WTD* 106-5 (3 June 2014).

248 The EU Code of Conduct Group had been mandated to review the third criterion (economic substance) of the Code of Conduct on Business Taxation in the context of patent box regimes. See HJI Panayi (2015), *fn.*35, chapter 5.

2014 the Code of Conduct Group reported to ECOFIN, announcing that it had come to an agreement on the interpretation of economic substance in this context. The Code of Conduct Group endorsed the modified nexus approach,[249] with a reservation from the Netherlands.[250] Overall, it was concluded that the patent box regimes in the EU were not compatible with the nexus approach and should be amended.

As for the exchange of tax rulings suggested under Action 5, this could reasonably be considered as a by-product of instruments dealing with exchange of information which have expanded exponentially in the past few years. Through changes to the Mutual Assistance Directive discussed in Part IV.3, a much more expansive version of this proposal has already been adopted in the EU.

As for tax abuse and treaty shopping, the proposals clarify, consolidate and rationalise anti-treaty shopping rules that are already in existence. The proposals contain minimum standards, changes to international (soft) standards and best practices recommendations. The drafting suggests a lot of flexibility. One could argue that these rather organic changes would have been made anyway. The same could also be said about the proposals under Action 7. They were likely to be developed in the normal course of affairs – the OECD Model is, after all, an ambulatory instrument. These proposals have been adopted by the European Commission in its recent Recommendation on implementation of measures to tackle tax treaty abuse,[251] produced under the ATAP, with the caveat that the rule should be modified to comply with EU case law such that genuine economic activity is not affected.

The changes to the Transfer Pricing Guidelines are also very comprehensive – though nothing radical. There is a refinement of the application of the arm's length principle in specific areas and in very rare cases, deviations from it.[252] The overwhelming majority of the reforms are, however, strongly embedded in the arm's length principle.

It is obvious that for the time being the OECD has no inclination whatsoever to move away from the arm's length principle, however much some of the BEPS discussion drafts seem to transform it from a pricing standard to a behavioural standard.[253] In any case, replacing the arm's length principle is not currently an option as most of the traditional OECD member countries are strongly resisting it.

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249 See Stephanie Soong Johnston, *"EU Clarifies Position on Patent Box Inquiry"*, 2015 WTD 25-2 (6 February, 2015). Also see William Hoke, *"European Commission Expands State Aid Inquiries"*, 2014 WTD 243-2 (18 December, 2014)

250 The Netherlands appeared to disagree with the limitation on the scope of the assets that would qualify for preferential treatment. For the Netherlands it was important that IP regimes were not limited to patents, but could also cover other innovations derived from R&D, provided that such activities had been certified by a competent government authority (not being the tax authorities), so that the linkage between R&D, IP-assets and profits (tracking and tracing) could be ensured. See reservation to be inserted to Council conclusions in the minutes of the ECOFIN Council on 9 December 2014 (Doc: 16846/14 FISC 233 ECOFIN 1196 (11 December, 2014), para 2.

251 C(2016) 271 final

252 Yariv Brauner, *"Transfer Pricing in BEPS: First Round – Business Interests Win (But, Not in Knock-Out"*, 43 (2015) 1 Intertax 72-84, 73-74

253 See Jens Wittendorff *"More Black Smoke From the OECD's Chimney – Third Draft on Intangibles"*, Tax Notes Int'l, Jan. 12, 2015, p. 167; 77 Tax Notes Int'l 167 (Jan. 12, 2015), p. 172

What does seem to emerge from the BEPS project, though again, to an extent, this could have resulted anyway, are increased reporting requirements for MNEs. As discussed above,[254] under Action 13, the OECD recommended that MNEs prepare master files and local files for transfer pricing documentation purposes, as well as the country-by-country report. This is an important minimum standard and many countries are in the progress of adopting such rules.

For example, in December 2015, the French Parliament adopted a country-by-country reporting requirement for multinational companies, applicable to financial years beginning on or after 1 January 2016.[255] In July 2015, the country-by-country reporting obligations came into force and will apply from 1 January 2016.[256] In January 2016, the Irish Revenue authorities published the Taxes (Country-by-Country Reporting) Regulations 2015, which apply from 1 January 2016.[257] The US Treasury Department and the Internal Revenue Service have been working on regulations that would require annual country-by-country reporting by the US persons that are the ultimate parent entity of an MNE group.[258] In addition, it has been reported that Korea intends to implement country-by-country reporting with effect from 2017. The necessary transfer pricing documentation legislation is expected to be enacted before the end of 2016.[259]

On 5 October 2015, the UK HMRC launched a technical consultation process. The consultation aims to ensure that country-by-country reporting will be implemented in the UK, with effect for accounting periods commencing on or after 1 January 2016. An updated policy paper was published in February 2016.[260] The UK's Taxes (Base Erosion and Profit Shifting) (Country-by Country Reporting) Regulations 2016 SI 2016 No 237 were laid before parliament on February 26, 2016, and have applied since March 18, 2016.

As also discussed above,[261] in the context of its Anti-Tax Avoidance Package (ATAP) in January 2016, the European Commission proposed an amendment to the Mutual Assistance Directive 2011/16/EU to ensure adoption of the BEPS country-by-country reporting requirements.[262] Emboldened by the release of the Panama papers, in April 2016, the European Commission proposed legislation requiring public

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254 See Part III.11
255 France - Amending Finance Law 2015 – adopted (22 Dec. 2015), News IBFD. Also see France; OECD - Country-by-country reporting requirement adopted by French parliament (13 Nov. 2015), News IBFD.
256 See Royal Decree 634/2015 of 10 July 2015, on corporate income tax regulations. Spain - Corporate income tax regulations published – country-by-country reporting (17 July 2015), News IBFD.
257 Ireland; OECD - Taxes (Country-by-Country Reporting) Regulations 2015 published (08 Jan. 2016), News IBFD.
258 United States - Corrections issued for proposed regulations on country-by-country reporting regarding multinational enterprise groups (01 Mar. 2016), News IBFD; United States - Proposed regulations issued on country-by-country reporting regarding multinational enterprise groups (23 Dec. 2015), News IBFD.
259 Korea (Rep.) - Country-by-country reporting to commence in 2017 (30 Mar. 2016), News IBFD.
260 See https://www.gov.uk/government/publications/country-by-country-reporting-updated/country-by-country-reporting-updated
261 See Part IV.3
262 Proposal for a Council Directive amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation, COM/2016/025 final - 2016/010 (CNS)

country-by-country reporting from many EU enterprises.[263] This initiative takes the form of a proposal to amend the Accounting Directive 2013/34/EU. It is accompanied by a long impact assessment on public tax transparency rules for multinationals formally underpinning the Commission's proposal.[264] Therefore, MNEs doing business in the EU are likely to be subject to additional reporting standards, and possibly, public country-by-country reporting for large MNEs.

Action 11 raises the possibility of tax authorities requiring from MNEs to provide additional firm-level information to assist authorities in analysing the extent of base erosion and profit shifting. Action 12 makes several recommendations for mandatory disclosure rules. Action 5 provides for spontaneous exchange of taxpayer-specific rulings related to preferential regimes. All these are in addition to the US-led FATCA reporting system and its accompanying intergovernmental agreements, as well as in addition to the OECD's Common Reporting Standard for automatic exchange of financial account information, aimed primarily at financial institutions.[265]

One could argue that whilst at the launch of the BEPS project the OECD was realistic enough not to anticipate going back to basics, nevertheless, the BEPS discussion drafts have in many instances fuelled important developments worldwide and fast-tracked changes – some of these important improvements - to the current standards.

3. Unilateralism and Fragmentation

As mentioned,[266] to an extent, the divergent interests of all the active participants to the BEPS project may have eroded the OECD's traditional consensus-built model. Rather than encourage uniformity, the OECD is now offering options which could lead to more non-uniformity among country laws and could exacerbate the unilaterality problem. It could also generate more opportunities for tax arbitrage (for companies) and tax competition (for countries).

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263 The proposed public reporting would apply to groups with a consolidated turnover exceeding EUR 750m. For EU headquartered groups, the obligation would fall on the ultimate parent enterprise in the EU. For groups headquartered outside the EU, the obligation would on their medium and large sized subsidiaries and branches within the EU. See Proposal for a Directive of the European Parliament and the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches**,** COM/2016/0198 final - 2016/0107 (COD). Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016PC0198

264 See Commission Staff Working Document Impact Assessment, assessing the potential for further transparency on income tax information Accompanying the document Proposal for a Directive of the European Parliament and of the Council amending Directive 2013/34/EU as regards disclosure of income tax information by certain undertakings and branches. Available at: http://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:52016SC0117

265 See Christiana HJI Panayi, *"Current Trends on Automatic Exchange of Information"*, SMU School of Accountancy (January 2016)

266 See Part V.1 and V.2 of this paper

Even before the finalisation of the BEPS final reports, it was obvious that several countries were not going to wait for a consensus approach.[267] What was more surprising though was that some countries that had been at the core of nations leading the BEPS project were considering taking unilateral actions or had already taken such actions, even before the final recommendations were produced in October 2015.[268] One could argue that some countries were in fact using BEPS as an excuse for unilateral actions.[269]

Arguably, the UK's Diverted Profits Tax (DPT) is the best example for this.[270] The DPT, also misleadingly called the Google Tax, seems to be based on the idea that the volume of sales of an entity in a particular country should determine the tax paid in that country i.e. it should be a connecting factor for exercising tax jurisdiction.[271]

The DPT was introduced in the UK in 2015.[272] It was intended to apply to large MNEs with business activities in the UK who entered into contrived arrangements to divert profits from the UK by avoiding a UK taxable PE and/or by other contrived arrangements between connected entities. Broadly, the DPT applies in two situations: when a foreign company artificially avoids having a UK PE (essentially where a person is carrying on activity in the UK in connection with supplies of good and services by a non-UK resident company to customers in the UK) and when a UK company, or a foreign company with a UK PE, creates a tax advantage by using entities or transactions that lacked economic substance. Under the DPT legislation, non-resident companies have a duty to notify HMRC if it was *reasonable* for the company to assume that it is potentially within the scope of the DPT legislation.[273]

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267 See Amanda Athanasiou, *"Jumping the Gate on BEPS: Unilateral Actions Weaken OECD's Plan",* 2015 WTD 49-2 (13 March, 2015); Amanda Athanasiou, *"The Cost of BEPS",* 2015 WTD 9-1 (14 January, 2015); Margaret Burow, *"Countries Aren't Waiting on OECD to Implement BEPS",* 2014 WTD 218-2 (12 November, 2014)

268 According to data compiled by PWC, more than 30 unilateral BEPS-focused measures were introduced by at least 19 countries in 2014 alone. The measures included guidance and legislation or proposed legislation on hybrids, interest deductibility, CFC rules, harmful tax practices, artificial avoidance of PE etc. PWC TaxTalk Monthly, "*The forces and tensions shaping BEPS*", dated 1 April 2014. Available on: http://www.pwc.com.au/tax/taxtalk/assets/alerts/TaxTalk-Alert-BEPS-Apr14.pdf

269 HJI Panayi (2015), *fn.*35, chapter 9

270 For commentary, see Sol Picciotto, *"The UK's Diverted Profits Tax: Admission of Defeat or Pre-Emptive Strike?",* 2015 WTD 12-12 (20 January, 2015); David Stewart and Stephanie Soong Johnston, *"The UK Government reveals Details of Diverted Profits Tax",* 2014 WTD 238-1 (11 December 2014); Amanda Athanasiou, *"U.K. Diverted Profits Tax Remains a Work in Progress",* 2015 WTD 29-4 (12 February, 2015); Heather Self, *"Diverted Profits Tax: Give BEPS a chance",* Tax Journal (15 December 2014)

271 Luca Cerioni, *"The New 'Google Tax': The 'Beginning of the End' for Tax Residence as a Connecting Factor for Tax Jurisdiction?",* 55 (2015) 5 European Taxation nyr. For a criticism of the DPT and the haste with which the UK government adopted it, see Heather Self, *"The UK's New Diverted Profits Tax: Compliance with EU Law"*, 43 [2015] 4 Intertax 333-336.

272 See Finance Act 2015. See Kristen A. Parillo, *"UK Diverted Profits Tax Legislation Both Narrowed and Broadened",* 2015 WTD 57-2 (25 March, 2015)

273 There has been criticism that this ground for notification is very vague and subjective. There is no duty to notify if HMRC has confirmed there is no need to do so or if it is reasonable for the company to assume that it has provided sufficient information to HMRC to enable the agency to decide whether to give a preliminary notice for that period and that HMRC has examined that information (either as part of an inquiry into a return or otherwise); or if it is reasonable for the company to conclude that no DPT charge will arise. Where the designated HMRC officer determines that the DPT should apply, a preliminary notice is issued. The recipient would have 30 days to make representations and the designated HMRC officer may consider certain specified matters within a further 30 day period before

The tax is at a rate of 25% on the diverted profits relating to the UK activity. The tax is not expected to arise where there is sufficient substance in offshore asset owning companies, or arm's length pricing through the international value chain or a taxable presence in the UK e.g. through a PE. There are also exemptions for small and medium-sized enterprises.

The DPT is a more targeted approach than that so far proposed by the OECD. It also appears to address one of the main criticisms on the OECD proposals on PEs, namely, that they would create a huge number of PEs and associated compliance burden but no significant additional tax in many circumstances. From that perspective, the DPT could be viewed as a more attractive option. Nevertheless, there is concern that the DPT is likely to give rise to considerable uncertainty in its application in the short-term. Although the intention of the DPT is to only narrowly target cases of 'contrived' avoidance of UK tax, the drafting of the provisions is very broad. The DPT applies to a large range of transactions across all industry sectors, even though it has been widely reported as targeting the digital sector.

There are also concerns in how the DPT would be applied and whether it would give rise to double taxation if more jurisdictions were to implement a similar tax. This type of tax has not been warmly received by all countries, especially by the US,274 though other countries are expected to follow suit. There are indications that Australia might adopt such tax, dubbed the Netflix Tax,275 in the context of is Tax Integrity Package. The Australian package includes tougher anti-hybrid laws, measures to reduce the tax burden on small businesses, and the creation of a taskforce to ensure that companies and wealthy individuals pay the proper amount of tax.276

By contrast to the DPT types of taxes, in other areas, mostly those with a procedure or information exchange element, there has been more uniformity. For example, the Action 13 proposals on country-by-country reporting have begun to be adopted by several countries, as explained above. Perhaps this is facilitated by the development of the OECD Common Reporting Standard and the international pressure for exchange of information.

Apart from reporting requirements, many countries around the world have started adopting rules or amending/entering into tax treaties which adopt some of the BEPS

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either issuing a charging notice on the original or a revised amount, or confirming that no charge arises. The charging notice requires the payment of the DPT within 30 days. Penalties apply for late payment.

274 For a selection of the issues arising, see Philip Wagman, "*The U.K. Diverted Profits Tax: Selected U.S. Tax Considerations*", Tax Notes, June 22, 2015, p. 1413; 147 Tax Notes 1413 (June 22, 2015). It has also been recently reported that a US district court found Puerto Rico's corporate alternative minimum tax regime – dubbed as the Walmart tax - as unconstitutional. Although this tax was first enacted in 1987, it has recently been rebranded as an anti-profit-shifting measure and bears many similarities with the UK's DPT. Ajay Gupta, "*A Google Tax by Any Other Name*?", Tax Notes Int'l, Apr. 18, 2016, p. 224; 82 Tax Notes Int'l 224 (Apr. 18, 2016)

275 See Harsh Arora, "*Understanding Australia's 'Netflix Tax'*", Tax Notes Int'l, Dec. 14, 2015, p. 931; 80 Tax Notes Int'l 931 (Dec. 14, 2015)

276 See the Australian Treasury's consultation paper, entitled "Implementing a diverted profits tax", published on 3 May 2016, available at: http://www.treasury.gov.au/ConsultationsandReviews/Consultations/2016/Implementing-a-diverted-profits-tax. Also see William Hoke, Australian Budget Includes Diverted Profits Tax to Fight Profit-Shifting, Doc 2016-9225 (4 May 2016)

recommendations. For example, in January 2016, China and Japan entered into a tax treaty which adopts some of the recommendations on Action 2 and 6, and mandatory binding arbitration for MAP disputes. In February 2016, the Obama administration and the US Treasury released its fiscal year budget proposals for 2017, which include proposals on hybrids, digital goods and services and excessive interest deductions. Also, as expected,[277] the latest US Model Tax Treaty[278] reflects some of the BEPS policy concerns such as double non-taxation, stateless income via treaty shopping. In fact, it is thought that the US delegation may have influenced the latest Action 6 discussion draft and the Final Report in line with the forthcoming US Model's changes.[279]

The UK is expected to introduce new rules in line with the proposals under Action 2[280] and Action 4.[281] The monitoring of BEPS implementation by several countries is likely to become even more complex.[282] Furthermore, the EU, in the context of its Anti-Tax Avoidance Package, has produced the anti-tax avoidance directive which, if adopted by Member States, will require that they adopt rules on CFCs, thin cap, hybrids etc.

4. Final Thoughts

Certainly the implementation of the BEPS Package was never going to be an easy task, notwithstanding the OECD's 'grand' gesture to aim for more inclusiveness. The fact that out of the 15 Action items, only a few proposals have translated into more concrete political commitments and the rest are mere recommendations or best practices, suggests that the OECD is keeping the barge pole rather low. To an extent, the final outcomes suggest that the OECD is not expecting uniformity in most areas and is willing to accommodate several approaches. This raises systemic challenges for international tax law and prolongs its inherent structural weaknesses. It inevitably leads to unilateralism and fragmentation – arguably, more structured unilateralism and fragmentation, but still, the same phenomena that the OECD sought out to address at the launch of the BEPS project. Moreover, some of the proposals (e.g. the menu of options for CFCs or the interest deductibility rules) are likely to generate more tax competition rather than less.

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277 See Kristen A. Parillo, *"Model Treaty Proposals Reflect Dramatic Change in US Policy",* 2015 WTD 99-1 (22 May, 2015)

278 See US Model Tax Convention 2016, available at: https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf Also see Preamble to US Model published on 17 February 2016, available at: https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Preamble-US%20Model-2016.pdf

279 HJI Panayi (2015), *fn.*35, chapter 9

280 The draft legislation is in the Finance (No. 2) Bill, clause 62 and Schedule 10, which will add a new section 6A to the TIOPA 2010.

281 See reference in *fn.* 98

282 For an excellent website which gives information on how several countries have adopted or are in the process of adopting legislation or guidelines in line with the BEPS recommendations, see the EY BEPS developments trackers, available at: http://www.ey.com/GL/en/Services/Tax/ey-beps-developments-tracker

It is hoped that with the tightening of the anti-avoidance rules and as reporting becomes ever more global, there will be fewer areas in which multinationals and individuals can hide from tax authorities. The OECD/G20's BEPS project is certainly not panacea. In fact, there is a risk that the costs of BEPS and the compliance costs generated from some of the actions might be out of line with any additional revenue that the governments might collect. Nevertheless, it is a good starting point for gradually reforming the international tax system in a realistic and inclusive way.