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Foreword

This Discussion Paper was prepared for the German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE) as part of its research and advisory work for the German Federal Ministry of Economic Cooperation and Development (BMZ) in the course of the German G20 Presidency.

The BEPS Monitoring Group (BMG) is a network of experts on various aspects of international tax, set up by a number of civil society organisations which research and campaign for tax justice including the Global Alliance for Tax Justice, Red de Justicia Fiscal de America Latina y el Caribe, Tax Justice Network, Christian Aid, Action Aid, Oxfam, and Tax Research UK. Our reports are not approved in advance by these organizations, which do not necessarily accept every detail or specific point made in them, but they support the work of the BMG and endorse its general perspectives. The lead author of this report was Sol Picciotto (United Kingdom), with contributions and comments from Agustina Gallardo (Argentina), Jeffery Kadet (United States), Markus Henn (Germany), and Maria Villanueva (Spain). We are also grateful for comments from OECD officials, staff of the German Development Institute / Deutsches Institut für Entwicklungspolitik (DIE), and an anonymous reviewer.

April 2017

Sol Picciotto

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Abbreviations

AEoI	automatic exchange of information
AML	anti-money-laundering
AOA	authorised OECD approach
ATAD	anti-tax avoidance directive
ATAF	African Tax Administration Forum
BEPS	base erosion and profit shifting
BIAC	Business and Industry Advisory Committee
CbCR	country-by-country report
CCCTB	common consolidated corporate tax base
CFA	Committee on Fiscal Affairs
CFC	controlled foreign corporation
CIAT	Centro Interamericano de Administraciones Tributarias
CRS	common reporting standard
CTPA	Centre for Tax Policy and Administration
DTA	double taxation agreement
EBITDA	earnings before interest, tax, depreciation and amortisation
EoI	exchange of information
EUR	euros
FATCA	Foreign Account Tax Compliance Act (United States)
FATF	Financial Action Task Force
FTA	Forum on Tax Administration
GDP	gross domestic product
HMRC	Her Majesty's Revenue and Customs (the UK tax authority)
IBFD	International Bureau for Fiscal Documentation
IMF	International Monetary Fund
IMF-FAD	International Monetary Fund Fiscal Affairs Division
IP	intellectual property
JITSIC	Joint International Taskforce on Shared Intelligence and Collaboration
LoB	limitation of benefits
MAP	mutual agreement procedure
MC	multilateral convention
MNE	multinational enterprise
OECD	Organisation for Economic Co-operation and Development
PE	permanent establishment
PPT	principal purpose test
SLoB	simplified limitation of benefits
TFDE	Task Force on the Digital Economy

TIEA	Tax Information Exchange Agreement
TPGs	Transfer Pricing Guidelines
TUAC	Trade Union Advisory Committee
UNDP	United Nations Development Programme
UNTC	United Nations Tax Committee (Committee of Experts on International Cooperation in Tax Matters)
USD	United States dollars
WBG	World Bank Group
WP	Working Party

Executive summary

The project on ‘Base Erosion and Profit Shifting’ (BEPS) has been the first major multinational effort to reform international tax rules since they were first designed in the 1920s. This report explains the background to the project, analyses the dynamics of the process, and evaluates the outcomes. The taxation of multinational enterprises (MNEs) continues to pose a central challenge for global governance, and increasing and widespread public concerns have forced it onto the global political agenda, through the G20 world leaders. Yet a wide gap separates the news headlines and political slogans from the technical complexities of the system and proposals for its reform. This report aims to help bridge that gap, by providing an analysis and evaluation of the progress made so far, aimed at all those interested in engaging with this important debate.

Although international tax coordination began through the League of Nations, since the 1950s it has not been dealt with by a global body. The main international organisations dealing with tax matters each have their own strengths and weaknesses. The leader on the legal and administrative aspects has been the Organisation for Economic Cooperation and Development (OECD). Its role has expanded rapidly, starting from the creation in 1956 of its Committee on Fiscal Affairs, to fill the gap created by the failure of the United Nations (UN) to take forward the work of the League of Nations in the coordination of the taxation of international business through tax treaties, resulting in the dominance of the OECD model tax convention. Especially in the past 20 years, it has grown to cover a wide range of tax policy and administration issues, working closely with tax authorities, especially since the formation in 2002 of the Forum on Tax Administration, at Tax Commissioner level.

The UN re-entered the field in 1967 with an Ad Hoc Group of Experts on International Cooperation in Tax Matters, which focused on adapting the OECD model to the needs of developing countries; but pressures to create an international tax organisation resulted only in a slight upgrade of this body to a Committee of Experts in 2004, in the Financing for Development Office. It remains severely under-resourced, and able to play only a supplementary role in work on tax treaties.

Both the International Monetary Fund (IMF) and the World Bank Group (WBG) provide high-quality analysis and advice on taxation, with a special emphasis on economic aspects and the needs of developing countries, especially through country missions. Attempts to coordinate the work of these and other organisations through the International Tax Dialogue had only moderate success, and a fresh start is being attempted through the Platform for Collaboration on Tax. Regional organisations of tax administrations are also playing an important part, especially in Africa, and Latin America and the Caribbean.

Political interest in international taxation first emerged in the 1970s in the context of concerns about the power of multinational enterprises, resulting in some technical work by the OECD on international tax avoidance and evasion. A particular focus was the rules on transfer pricing, which allow tax authorities to adjust the accounts of affiliates within MNE corporate groups to prevent the shifting of profits from high-tax to low-tax countries. Despite these efforts, exploitation by MNEs of the tax haven and offshore secrecy system increased, exacerbated by competition between states to attract investment by offering preferential tax regimes. A new political initiative in the mid-1990s through the G7 leaders

produced the OECD project on ‘Harmful Tax Competition’. Although this quickly lost momentum due to national political changes especially in the United States, some progress was made in improving transparency through exchange of information in tax matters, as well as an attempt to control preferential regimes.

Following the growth of a worldwide tax justice movement, and the financial crisis of 2007-2009, a more determined stance was taken by the G8 and then the G20. With this impetus, the OECD produced a new global standard for transparency through comprehensive, multilateral, automatic information exchange for tax purposes – the Common Reporting Standard (CRS). This is aimed primarily at tax evasion by wealthy persons, which is linked to wider issues of money-laundering, terrorist financing and capital flight. The relationship with problems of financial stability has helped to strengthen efforts at international coordination on transparency, but has sometimes weakened the tax aspects, since tax avoidance is not normally viewed as criminal. Work is continuing on effective implementation, especially to ensure comprehensive compliance with the CRS especially by leading financial centres, as well as availability of information on beneficial ownership.

The fiscal pressures resulting from the financial crisis also led to a new initiative to curb corporate tax avoidance, through a project on base erosion and profit shifting (the ‘BEPS Project’), initiated through the OECD, spurred on by the G8, and given strong political support by the G20 leaders in 2013. The BEPS Action Plan worked to a very tight timescale, and delivered its outputs in October 2015 to the OECD and G20, in the form of thirteen extensive reports covering the 15 points of the Action Plan, with many detailed technical recommendations. These focus on patching up the defects of current international tax rules which, if implemented, could strengthen the powers of those national tax administrations able and willing to use them. Some entail new and innovative measures, especially the creation of a global mechanism for country-by-country reporting and transfer pricing documentation, and stricter and harmonised rules to limit the deductibility of interest expense. However, although there has been some strengthening of transfer pricing rules, they remain reliant on subjective judgements, and agreement has been lacking on clear criteria for determining how MNEs’ profits should be allocated according to ‘where economic activity occurs and value is created’, as mandated by the G20. Work is continuing on the key issues left unfinished in the BEPS project, regarding profit attribution and the profit-split method, as well as the wider tax aspects of digitalisation of the economy.

Implementation of the BEPS project recommendations is a major challenge, and will require continued coordination by the OECD. Revisions of the formal legal framework should be facilitated by a new multilateral convention, which will have its signing ceremony in June 2017, with subsequent ratifications by states. It attempts to balance flexibility with coherence through a complex system of permitted reservations, but political support will be needed to ensure it is not fatally weakened by unnecessary opting-out especially by leading states. Other BEPS measures depend on national action, some underpinned by international soft law, particularly the Transfer Pricing Guidelines.

Significant implementation has already occurred, although selectively and tending to the minimum standard levels; and there has been some harmonisation through EU directives, although a more contentious proposal is currently held up by objections from a few states. Implementation will be monitored through a system of peer-review being formulated by the

OECD, especially for the four actions which are regarded as minimum commitments: measures to counter treaty abuse; the control of harmful tax practices; country-by-country reporting; and strengthening dispute resolution. Here again, political commitment will be essential to ensure effective action, especially in relation to curbing harmful tax practices, the procedural and institutional arrangements for which have the potential to stimulate either a beneficial movement to the top or a damaging race to the bottom, evidenced by the widespread adoption of patent box regimes despite evidence of their unsuitability.

The political challenges of both the continuing tax agenda and of implementation of the BEPS outcomes could be exacerbated by the proliferation of unilateral measures, which could even become an international tax war. The inability so far to agree on clear criteria for allocation of profit, especially due to digitisation, has already led to enactment of various different state measures. These include taxes on ‘diverted profits’, new withholding taxes on fees for digital services, and more aggressive interpretations of rules on taxable presence and attribution of profits.

Much will depend on the form taken by US reform of its international tax rules, which has become urgent, especially to reduce the headline rate on corporate profits to align with other countries, and facilitate repatriation of profits held offshore. The more difficult and contentious issue is definition of the tax base: while good economic arguments have been made for a shift to a destination-based cash flow tax, adoption of a sales-based definition could, depending on the border tax adjustment for allowable expenses, amount to discrimination against imports and in favour of exports. This would be both a sharp departure from accepted international tax norms and a violation of world trade rules, threatening major conflicts.

Nevertheless, the serious consideration being given to such proposals in the US Congress reflects the impatience in many quarters with the limitations of the solutions so far proposed in the BEPS Project to deal with the ability of MNEs to minimise taxation, by shifting profits internally among affiliates in the corporate group, which are treated as independent entities under international tax rules, although in reality they are under centralised control.

The recent widening of the G20’s tax agenda to extend to tax certainty, as well as taxation for inclusive growth, should therefore not neglect the unfinished corporate tax reform issues, resolution of which remains essential to both clarity and predictability and fairness of taxation. Important questions also remain about the international institutional structure, especially to ensure effective involvement of developing countries. Some G20 states made significant commitments in the Addis Tax Initiative to collectively double their spending on tax in the context of domestic resource mobilisation, but this was from a very low base, and both monitoring of compliance with the commitments and better coordination of bilateral capacity building are needed.

However, it is a wasteful use of scarce resources to try to build capacity to implement rules which are inappropriate or defective. The OECD has made great efforts to extend involvement in the BEPS Project to all states on an equal footing, now through the Inclusive Framework endorsed by the G20. However, this would merely entail non-OECD non-G20 countries being expected to implement recommendations which they had little part in formulating, unless there is an explicit resetting of the agenda to reflect their concerns, and

a willingness to consider new approaches. There is also a great need for additional resources to facilitate the active participation of both governmental representatives and civil society in the debates and decision-making over policies and rules. Continuing pressures to create a global tax body merit a more convincing reply, perhaps in the form of a roadmap towards both institutional and substantive international tax reforms which could have truly global legitimacy.

Above all, strong political leadership is needed to overcome the collective action problem leading to tax competition and a race to the bottom in corporate taxation. Whatever the economic arguments for and against taxing corporate profits, few states today can neglect this important source of government revenue. Exploitation of the opportunities for avoidance gives MNEs a competitive advantage over the mainly small domestic firms, and distorts the allocation of investment. Citizens around the world support taxation to provide good public services and a powerful economy, but also strongly feel that a fair share must be paid by both wealthy persons and large corporations. In a globalised economy, this requires international cooperation and coordination. All those involved in this issue must play their part, but a particular responsibility lies on political and corporate leaders to provide a new impetus for a better approach.

1 Introduction

The international tax system was born in the ferment following the First World War, in a climate of financial instability and political uncertainty. It resulted from technical studies in the 1920s and international negotiations in 1928 through the League of Nations. The basic technical structure designed at that time has survived with relatively minor changes for almost a century. It has played a central role in stimulating international investment, especially through multinational enterprises (MNEs). Yet concerns have periodically surfaced about the weaknesses in its foundations, which have facilitated and even encouraged international tax avoidance strategies by MNEs, and evasion by the wealthy. These concerns have grown following the financial liberalisation and renewed economic globalisation since the 1980s (Kadet, 2016).

The resulting initiatives have produced a significant improvement in exchange of information and some greater transparency in tax matters but so far only a patch-up of the structure and substantive rules. An important reason for this incremental response has been the weakness of the international institutional framework for tax. This has created a major gap between the political and policy debates and the complexities of the detailed technical provisions. Certainly, tax is central to state sovereignty. Yet so are many other key issues for which global institutions have been constructed. Especially since the 1980s, international tax evasion and avoidance by wealthy individuals and powerful corporations have weakened both the effectiveness and the legitimacy of national taxation. This has become even more evident in the fiscal crises which followed the financial crash of 2007-2009. In a world in which states are interdependent and the economy is increasingly globally integrated, stronger international coordination and cooperation on tax is essential to restoring real national sovereignty. Despite the resurgence of populist nationalism, there is widespread global support for more effective international action to crack down on tax avoidance and evasion.

This paper therefore begins with a section outlining the international institutional structure for tax, and an account of the various initiatives for its reform. Subsequent sections will focus in particular on the most recent initiative, the BEPS Project, and reflect on the current conjuncture and prospects for the immediate future.

2 International tax governance

2.1 History and structures

A number of international governmental organisations (IGOs) deal with tax issues, including both national and international tax policy:

- The IMF (Fiscal Affairs Department: IMF-FAD);
- The OECD (Centre for Tax Policy and Administration (CTPA));
- The World Bank Group (WBG);
- The UN Committee of Experts on International Cooperation in Tax Matters (UNTC).

In April 2016, these four bodies formed the Platform for International Collaboration on Tax, a coordination brokered by the G20 Finance Ministers in Shanghai in February 2016.¹ In addition, there are regional and sub-regional governmental organisations for tax cooperation. The two most established are the African Tax Administration Forum (ATAF), founded in 2008, and the Centro Interamericano de Administraciones Tributarias (CIAT), founded in 1967. The European Commission of course plays an important role in the EU; although hampered by the need for unanimity among member states for direct tax issues, it has been more proactive recently due to their increased political salience. Regional development banks also work on tax, mainly giving country advice and capacity building.

Despite extensive economic globalisation, tax policy is still regarded as a matter of national sovereignty, even in relation to international business. A formal legal structure or skeleton for international tax coordination is provided by double taxation agreements (DTAs), negotiated mostly bilaterally between states, but based on model conventions. It is estimated that there are about 3,000 such DTAs currently in effect, as well as some 1,300 tax information exchange agreements (TIEAs) that provide for increased transparency between jurisdictions. DTAs date back to the first model conventions, drawn up at a League of Nations conference in 1928, which set up a Fiscal Committee. This Committee issued a new model treaty in Mexico in 1943, influenced by Latin American capital-importing countries, which tended to favour taxation at 'source' (that is, where the income is generated), as opposed to 'residence' (the home country of the investor). A subsequent London model of 1946 shifted towards residence taxation. The United Nations set up a Financial and Fiscal Commission to continue the work of the League, but it quickly became deadlocked by east-west and north-south splits, and ceased to meet after 1954.

2.1.1 The OECD

In 1956, a Fiscal Committee was set up under the then Organisation for European Economic Co-operation, renamed in 1961 the Organisation for Economic Co-operation and Development (OECD). The Committee on Fiscal Affairs (CFA) is now the main decision-making body for the OECD's broader tax work in the CTPA. The CFA operates through Working Parties, which continue until no longer needed and to which governments send officials specialised on the particular topic. Working groups can be set up ad hoc (and funded from outside the core OECD budget), and it now has a number of other subsidiary bodies. The CFA is distinctive in that it brings together governmental representatives, and its work results in the continuous creation of 'soft law' standards: model conventions, commentaries and guidelines.

The CFA consists of senior international tax officials representing OECD member states, as well as some observer non-member states, now serviced by well over 100 professional staff. For the project on base erosion and profit shifting (BEPS), non-OECD G20 members, and since 2016 countries joining the Inclusive Framework on BEPS, have been admitted 'on an equal basis'. Its key strategic body is the Bureau, which has gained importance as the number of participants, especially in the BEPS project, has grown. Martin Kreienbaum, head of international and EU tax in the German Federal Ministry of Finance, succeeded

1 It superseded the International Tax Dialogue, see below.

Masatsugu Asakawa of Japan as Chair of the CFA and of its Bureau in December 2016. For BEPS issues, there is an enlarged Bureau, or Bureau-Plus.²

The scope of the OECD’s work on tax has expanded greatly, especially in the past 20 years, reaching well beyond tax treaties to encompass the full range of tax policy questions.³ A key shift was the creation in 2002 of the Forum on Tax Administration (FTA), directed by a Bureau of 13 Tax Commissioners, which now has 46 members, including most non-OECD G20 countries. In addition to projects on topics such as advanced data analytics, capacity building and e-services, it now hosts key programmes relating to international tax evasion and avoidance.⁴ These are:

- The Offshore Compliance Program (led by France), which coordinates the sharing and use of data on bank accounts of non-residents resulting from the Common Reporting Standard (CRS), and the system for automatic exchange of information (AEOI);
- the Joint International Taskforce on Shared Intelligence and Collaboration (JITSIC) Network (sponsored by Australia),⁵ created in 2004 as a low-profile body between Australia, Canada, the United States and the United Kingdom, which expanded to 20 members in 2009, was refounded in 2014 and now has 35 members, working on combating corporate avoidance and coordinating cross-border enforcement; and
- the FTA MAP Forum (led by the United States), which aims to improve international tax dispute settlement through the Mutual Agreement Procedure (MAP).

The CTPA also includes some other bodies, in particular it hosts the Global Forum on Transparency and Exchange of Information for Tax Purposes,⁶ the Task Force on Tax and Development, and Tax Inspectors without Borders (in partnership with the United Nations

2 Following the endorsement of the BEPS Project by the G20, Brazil, China, India and South Africa were elected to the ‘Bureau Plus’, responsible for the BEPS Project. This became the Bureau ++ with the creation of the Inclusive Framework, adding Georgia, Nigeria, Senegal and Singapore, as well as Argentina from the G20, while the OECD country members are Canada, France, Germany, Italy, Japan, the Netherlands, Norway, Spain, Switzerland, the United Kingdom and the United States (Composition as at 31 January 2017).

3 This took place during the leadership of Jeffrey Owens: when he joined the Tax Division in 1971 there were three staff, and when he became its head in 1983 still only seven, but by the time he retired in 2012 it had 125, of whom around 100 were professional grade. Many have been seconded from or are former officials of national tax authorities, but often also have private sector experience, and OECD officials also often move to the private sector. Despite the widening of state participation in the CFA, only nationals of OECD member states are eligible to work for the OECD. Owens skilfully steered the expansion, by initiating work on new tax policy topics (e.g. consumption taxes) using voluntary contributions from interested states, and leveraging support from senior tax policymakers to expand its share of the OECD core budget, and cement its wider role. A key strength was also the ability to respond with practical operational proposals in response to political concerns, especially in the mid-1990s, when the G7 first asked the IMF for policy ideas before turning to the OECD.

4 See its publication Highlights and Achievements, available at <https://www.oecd.org/tax/forum-on-tax-administration/publications-and-products/fta-annual-report.pdf>.

5 Previously the Joint International Tax Shelter Information and Collaboration network, it has its own website <http://www.oecd.org/tax/forum-on-tax-administration/ftajitsicnetwork.htm>.

6 The Global Forum is formally a separate body (requiring contributions from its members for its budget), although it is serviced by the CTPA secretariat.

Development Programme (UNDP)).⁷ Its Global Relations Programme, funded by special contributions from many states and steered by an Advisory Committee co-chaired by Canada and Malaysia, runs technical training and other activities, and benefits from the Multilateral Tax Centres set up in Budapest and Vienna (both 1992), Ankara (1993), Korea (1997), Mexico (2004), and most recently China (2016).⁸

Participation in the meetings of all these bodies (except the Task Force) is only for members and officials, except by specific invitation. However, the CFA has held public consultations on proposals, which were frequent during the BEPS project, and consults especially with the Tax Committee of the OECD's Business and Industry Advisory Committee (BIAC). The Trade Union Advisory Committee (TUAC) formally has equal status with BIAC within the OECD, but only became involved with tax during the BEPS project. Although civil society organisations have no formal status at the OECD, efforts have been made to consult them, also during the BEPS project. Generally, however, corporate tax advisers have far outnumbered others in consultations. While this can be explained by the often highly technical nature of the proposals and the short deadlines for submissions, this has skewed the character and focus of outsider input into the process.

The OECD model convention, first outlined in 1959, published as a draft in 1963 and issued in 1977, became in practice the main model for actual DTAs. Although its basic text is quite short (although becoming longer due to the BEPS Project), it has extensive Commentaries. The CFA has also issued a number of reports on specific issues (now numbering 26), which are included as Appendices to the Full Version of its model convention. It is also responsible for the OECD Transfer Pricing Guidelines. All these documents have a quasi-legal status as 'soft law', especially as they are generally followed in practice by tax administrations, and often referred to by courts, even in non-OECD countries such as India and Kenya.

The OECD is also now mainly responsible for the Convention on Mutual Administrative Assistance in Tax Matters.⁹ The original text of 1988 was significantly revised in 2010, and thrown open to all states to join (subject to approval by the contracting parties). Finally, the OECD will be the depositary and administering organisation for the Multilateral Convention for the Implementation of Tax Treaty Measures Relating to BEPS (MC-BEPS), published on 24 November 2016.

2.1.2 The UN Committee

In 1967, the UN set up an Ad Hoc Group of Experts on International Cooperation in Tax Matters. The work of this group focused on adapting the OECD model DTA to the needs of developing countries, in a UN model convention, first published in 1980. Some 30 years after the creation of the Ad Hoc Group, concerns to improve international economic governance in response to the challenges of globalisation resulted in proposals for an international tax organisation.¹⁰ These were supported in the Report of the High-Level Panel

7 Further details and organigrams in OECD Work on Taxation (OECD, 2016a).

8 See its website <http://www.oecd.org/ctp/tax-global/>.

9 Developed jointly with the Council of Europe, which formally remains a co-depositary.

10 Amongst others from Vito Tanzi, then head of the IMF-FAD.

on Financing for Development, chaired by Ernesto Zedillo (UN [United Nations], 2001), which also explored ideas for global taxes, such as a financial transactions (‘Tobin’) tax, and a carbon tax. However, the only result was a slight upgrading to a Committee of Experts (UNTC) in 2004, under the Financing for Development Office (FfDO). There have been continuing pressures for further upgrading, and a renewed drive to create a global tax body, most recently at the Addis Ababa UN Conference on Financing for Sustainable Development in 2015, which are continuing.¹¹

The UNTC consists of 25 individual experts, chosen for four year terms (renewable) by the UN Secretary-General from nominations by states; a new Committee will be appointed in 2017. Formally they do not represent their governments, although in practice they are generally government tax administration officials, usually those responsible for tax treaties, or sometimes transfer pricing. It includes members from OECD and G20 as well as developing countries, so the latter are in practice a minority.¹²

The UNTC’s work is still very much focused on revising its model convention and Commentaries, although its mandate is slightly wider, and includes other aspects of cooperation on tax. It has minimal resources (only two full-time professional staff, with a few more in the FfDO working on capacity building). Much of the UN’s model is identical to that of the OECD, and its Commentaries often include verbatim quotes from those of the OECD. However, some provisions differ significantly, and it has some articles not included in the OECD model, mainly strengthening taxation at source.¹³ Although the UN model is therefore a compromise between the two perspectives, a study for the UNTC showed that developing country treaties frequently include provisions from the OECD model rather than the UN version (IBFD [International Bureau of Fiscal Documentation], 2013).¹⁴ The UNTC also developed a Practical Manual on Transfer Pricing in 2012 (UN, Department of Economic and Social Affairs, 2017, 2nd Edition), which is generally in line with the OECD Guidelines, but includes a chapter of country reports from Brazil, China, India, Mexico, and South Africa, which indicate some deviations from the practices of OECD countries.

The UNTC’s funds have allowed only one annual meeting of five days, although from 2016 this has been extended to two meetings of four days each, due to additional funding resulting from the Addis commitments. However, the resources of the Secretariat have not been significantly increased, and it still has only two full-time tax professionals. Participation in the UNTC meetings, except for closed sessions, is extended to representatives from all UN member states, and accredited observers (who contribute to the discussions and other work). Substantial work is done between its meetings through subcommittees and working parties, established as needed. No UN funding is available for participation in subcommittees, which

11 Pressures at Addis were especially from India, and the current drive is through the G77 and China, led by Ecuador, with civil society support.

12 In the current Committee, 12 are from OECD countries (Chile, Germany, Italy, Japan, Mexico, New Zealand, Norway, Poland, Sweden, Switzerland, the United Kingdom, and the United States), 11 come from countries which are members of the G77 group (the Bahamas, Brazil, China, Ghana, India, Malaysia, Morocco, the Philippines, Senegal, South Africa, Zambia), and two others (Azerbaijan, Qatar).

13 Notably, it has just finalised a new model article allowing a withholding tax on fees for technical services. However, it should be noted that articles in the model convention are only a basis for negotiation of actual treaties. It has also set up a Subcommittee on Extractive Industries Taxation.

14 For a follow up study, linked to a publicly available database, see Hearson, 2016.

are essential in preparing the detailed technical proposals, or for secretariat support for this activity. This creates significant constraints on participation especially by developing country members, although sometimes special funding has been offered by some states.¹⁵ Unless a subcommittee is specifically restricted to members, non-members of the Committee may be appointed to them. Such participation is obviously easier for tax advisers from well-resourced firms, and they sometimes do substantial work including preparing drafts, as do academics.

2.1.3 Others

The IMF Fiscal Affairs Division (IMF-FAD) and the WBG deal much more widely with all types of tax and aspects of tax policy. Having no responsibility for designing tax treaties they can be, and have been, more critical of the effects and benefits of concluding treaties.¹⁶ Nevertheless, their country advice generally recommends adherence to international norms, although their work with developing countries leads to stronger concern for protecting source taxation. The rapid expansion of the role and size of the OECD has led to inter-organisational tensions. The International Tax Dialogue set up in 2009 facilitated some coordination mainly of research.¹⁷ The Platform, which has similar membership, now aims to deepen this, particularly by working together on specific policy papers. These include in particular eight toolkits for developing countries on aspects of taxation of MNEs, some on BEPS-related issues, to be produced by 2018.¹⁸

2.2 Political and technical initiatives for international tax reform

The League of Nations model conventions were intended to be for both ‘prevention of double taxation and of fiscal evasion’. In practice, however, the prevention of double taxation has been given priority, since the main aim of DTAs has been seen as the encouragement of international investment. This was especially so in the early period of development of the network of DTAs from the 1950s to the 1970s under the aegis of the OECD. Early concerns in the 1960s about tax avoidance by MNEs resulted in some national measures,¹⁹ but although the issue was raised by the United States at the OECD, no

15 During the UNCTC’s 14th session in New York in April 2017, the Secretariat presented a budget of some USD 680 thousand per year to an informal meeting to which potential donors had been invited, having had so far zero contributions to its Trust Fund.

16 See, for example, IMF [International Monetary Fund], 2014, pp. 25-28, recommending ‘considerable caution’ before entering into any DTA.

17 Set up as a collaborative initiative involving the EC (European Commission), IDB (Islamic Development Bank), IMF, OECD, UK-DFID (UK Department for International Development) and WBG, with which others such as the United Nations, ATAF and CIAT became associated.

18 The first, ‘Options for Low Income Countries’ Effective and Efficient Use of Tax Incentives for Investment’ was delivered in 2015, and a draft toolkit addressing the lack of transfer pricing comparables was released for public comment in January 2017. The basis for the Platform on Collaboration was outlined in a Concept Note of 19 April 2016.

19 In 1962, the United States enacted the first measures on controlled foreign corporations (CFCs), treating as taxable in the United States the ‘passive’ income of foreign subsidiaries in low-tax countries, and in 1968 the first Transfer Pricing Regulations. At the request of the German Parliament in 1962, the

international action resulted.²⁰ Only in recent years, especially with the BEPS Project, has there been any attempt to overhaul the rules to ensure that they also prevent what has come to be called ‘double non-taxation’.

2.2.1 The 1970s to 1990s

International tax became politicised in the 1970s in the context of concerns about the power of MNEs. In parallel, the CFA again took up the issue of abuse of tax treaties, leading to the establishment of CFA Working Party 8 on Tax Avoidance and Evasion in 1976. A particular focus was profit shifting through transfer pricing, highlighted by some prominent publicised cases. The issue was discussed in the report of the UN Group of Eminent Persons on the Impact of MNEs of 1974, which urged further work by the UN Group of Tax Experts. The OECD Guidelines for MNEs adopted in 1976 included an exhortation that they should ‘refrain from making use of the particular facilities available to them, such as transfer pricing which does not conform to the arm’s length standard ...’. A request from the OECD Council resulted in the CFA Report on Transfer Pricing and MNEs of 1979.²¹

This was prepared during the period of a strong transatlantic conflict over the application by some US states, especially California, of their ‘formulary apportionment’ system for state corporate taxes to the worldwide profits of MNEs (Picciotto, 1992, pp. 241-245). The 1979 Report strongly affirmed the ‘arm’s length principle’, rejecting ‘so-called global or direct methods of profit allocation’. It recommended five methods, in line with the US regulations of 1968, for adjusting prices of transactions between related parties based on comparable unrelated party transactions. However, by this time the United States itself was finding this approach unsatisfactory, leading to amendment of its legislation in 1986, and the introduction of a new ‘arm’s length return method’ focusing on the rate of profit and not transaction prices. This caused a major conflict in the OECD-CFA, which was eventually resolved by agreeing to add two new transfer pricing methods focusing on profits (Durst & Culbertson, 2003). The approved approach, with five authorised transfer pricing methods, was elaborated in the OECD Transfer Pricing Guidelines for MNEs and Tax Administrations of 1995 (latest version 2010) (the TPGs).

However, the arm’s length principle proved ineffective – indeed the ‘independent entity’ concept on which it was founded further encouraged strategies using tax havens. Essentially, these entail devising complex group structures, creating affiliates in convenient jurisdictions as holding companies to provide finance or own assets. These can charge interest or royalties, which reduce the tax paid by their operating company affiliates, while transferring the profits to low or zero tax offshore jurisdictions. Some countries introduced rules on

government produced a *Steueroasenbericht* (Report on offshore tax havens) in 1964, resulting in a decree in 1965 which had limited effects, and eventually the *Aussensteuergesetz* (German Foreign Transaction Tax Act) of 1972. For further details, see Picciotto, 1992, especially Chapter 7.

20 At the suggestion of the United States, the OECD-CFA in 1962 set up Working Party 21 on Avoidance through the Improper Use or Abuse of Tax Conventions, consisting of Denmark and the United States; its report in 1963 did not lead to any action at that time, but was revived in 1975.

21 The UN Group of Tax Experts, which included members from the OECD, produced a more low-key report on similar lines.

controlled foreign corporations (CFCs),²² aiming to tax these retained earnings ‘parked’ offshore. However, they had limited effects, especially as they were weakened due to complaints by MNEs to their home countries that such rules damaged their international competitiveness. The OECD-CFA attempted to analyse the problem in a lengthy four-part report (OECD, 1987). However, this focused mainly on the compatibility of the various national measures with tax treaty rules, since some states had challenged CFC rules as ‘extra-territorial’. Although the 1987 report recommended greater coordination of CFC rules, no further serious work was done.

Indeed, in the 1990s, states anxious to attract investment increasingly introduced new tax incentives and preferences. This led to further complex restructurings of MNE corporate groups, to take advantage of such preferences.

2.2.2 The G7 and the ‘Harmful Tax Competition Project’

The issue of international tax avoidance and evasion again became of political concern in the mid-1990s. The issue was referred to the G7 leaders, and their Lyon summit communiqué of 1996 stated:

16. Finally, globalization is creating new challenges in the field of tax policy. Tax schemes aimed at attracting financial and other geographically mobile activities can create harmful tax competition between States, carrying risks of distorting trade and investment and could lead to the erosion of national tax bases. We strongly urge the OECD to vigorously pursue its work in this field, aimed at establishing a multilateral approach under which countries could operate individually and collectively to limit the extent of these practices. We will follow closely the progress on work by the OECD, which is due to produce a report by 1998. We will also follow closely the OECD’s continuation of its important work on transfer pricing, where we warmly endorse the significant progress that the OECD has already achieved. (G7 Information Centre, 1996)

The result was the report on ‘Harmful Tax Competition: An Emerging Global Issue’ of 1998.

This report focused on the emergence of tax competition as a result of globalisation, and identified two problems: tax havens and ‘harmful preferential tax regimes’. It presented an insightful analysis of tax competition, with an awareness of the wide spectrum of interactions between countries’ tax policy choices, and especially the effects of incentives. It focused on the treatment of ‘geographically mobile’ income, and distinguished between i) tax havens, which generally impose no or nominal tax on such income; ii) countries which generally collect significant revenues from income taxes but offer preferential regimes; and iii) countries which have an effective tax rate generally lower than that of others. It determined that only the first two should be regarded as harmful.

Four criteria were put forward for identifying tax havens: i) no or nominal taxes; ii) lack of effective exchange of information; iii) lack of transparency; and iv) no requirement that activity be substantial. For harmful tax practices, it listed four key and seven additional

22 CFC measures aim to tax a parent company also on the profits of all the foreign corporations it controls, but normally only if they do not carry out genuine economic activities (defined by detailed rules), and are located in low-tax jurisdictions (often specified in a list of tax havens).

factors for determining regimes which could be considered to be ‘poaching’ the tax base of other countries,²³ and three criteria for evaluating these factors.²⁴ To combat both havens and harmful practices, it made a series of recommendations, for both domestic measures,²⁵ and tax treaties.²⁶

However, it also recommended multilateral action: the adoption of Guidelines for a common approach to restraining harmful tax competition, and the establishment under the CFA of a Forum on Harmful Tax Practices. The Guidelines committed states to refrain from adopting measures constituting harmful tax practices, and to remove any practices found to be harmful by the Forum, applying a procedure for listing potentially harmful measures and evaluating them. The Forum would continuously evaluate existing and proposed regimes, analyse the effectiveness of counter-measures, propose ways to improve them, and draw up a list of tax havens. The report also recommended that, within the context of the Forum, both OECD and interested non-member countries should examine additional issues.²⁷

A key feature of the report’s proposals was their global scope of application, and the identification of the need for coordinated counter-measures. It noted that harmful practices suppressed in one place could be displaced elsewhere, and outlined a worldwide outreach programme extending engagement especially to jurisdictions which might not agree with its recommendations. Its chapter on counteracting measures also stressed the need for these to be coordinated. The proposals were adopted by a Recommendation of the OECD Council in April 1998, but significantly weakened by abstentions from Luxembourg and Switzerland, which did not accept to be bound by the report; while Austria and Belgium also did not support the initiative. However, the support of the G7 (of which of course none of these states are members) provided the necessary political backing for it to move forward.

23 The key factors were: i) a low or zero effective tax rate; ii) a regime which is ring-fenced; iii) its operation is non-transparent; and iv) the country does not effectively exchange tax information with others. It added further factors: v) an artificial definition of the tax base; vi) non-adherence to international transfer pricing principles; vii) exemption of foreign income; viii) a negotiable tax base or tax rate; ix) bank and other secrecy provisions; x) a wide network of tax treaties; and xi) encouraging tax driven activities with no substantial activities.

24 These were whether i) a regime merely shifts activity from one country to another; ii) the activities in the country are commensurate with the investment or income; and iii) the preferential regime is the main motive for location.

25 On controlled foreign corporations (CFCs) and foreign investment funds; restricting participation exemptions and other measures exempting foreign income; reporting rules for foreign transactions; transparency of procedures for making tax rulings; consistent application of transfer pricing rules; and removing restrictions on access to bank information for tax purposes.

26 Greater and more effective use of exchange of information especially about transactions with tax havens; inclusion of provisions in tax treaties to restrict their benefits being granted inappropriately, and clarification of the applicability of domestic anti-abuse rules; termination of treaties with tax havens; strengthening and extension of coordinated enforcement programmes, and development of provisions for assistance in collection.

27 Those it mentioned were restriction of deductions for payments to tax haven entities; withholding taxes on payments to residents of countries engaging in tax competition; corporate residence rules; adding provisions to the transfer pricing guidelines on their application to havens and harmful tax competition regimes; reviewing rules on thin capitalisation; and monitoring innovative financial products such as derivatives.

The project was then severely weakened by a change of policy of the new US Administration under President George W. Bush in 2001, which rejected those aspects which it viewed as attempts to dictate how a country should structure its tax system. This led to a refocusing on transparency, and the renaming of the project as ‘harmful tax practices’.²⁸ The work on tax preferences culminated in a report in 2006 which evaluated 47 preferential tax regimes that had been identified as potentially harmful; it found that 18 had been abolished and 14 amended to remove their potentially harmful features, while another 13 were found not to be harmful, as were a number of holding company regimes additionally considered.²⁹

The project became mainly targeted at improving exchange of information (EoI) for tax purposes. This entailed strengthening of the EoI provisions in DTAs, and developing specific Tax Information Exchange Agreements (TIEAs) for countries whose tax systems were not suitable for DTAs (that is, the havens with no income taxes). Although a multilateral TIEA was published, it was decided to treat this as a model for states to negotiate bilaterally. The threshold to satisfy the transparency test and avoid being listed as a haven was set at 12 TIEAs, which became discredited as havens began negotiating treaties with each other. This also showed the weakness of the ‘black-list’ approach, which was later replaced by three categories (see subsection 2.4 below).

2.3 The link between finance and tax

Since tax began to be raised in the G7, it has been dealt with in the finance track. Especially with the shift to a focus on tax transparency, it became linked to earlier initiatives on anti-money laundering (AML), and to some extent offshore financial centres. However, the relationship between tax havens and offshore finance has not always been well understood, and coordination of measures has been difficult.³⁰

This was exacerbated by the compartmentalisation of responsibility for technical measures. Cooperation on AML is led by the Financial Action Task Force (FATF), which was originally set up by the G7, and today has 35 members. Although based at the OECD in Paris, it is organisationally separate, and did not forge close links with the CTPA. Monitoring of

28 Statement of Paul H. O’Neill, Secretary to the Treasury, before the Senate Committee on Governmental Affairs Permanent Subcommittee on Investigations, 18 July 2001. This also called for withdrawal of the ‘no substantial activities’ criterion, but the Forum did not change its criteria.

29 The only one considered harmful was that of Luxembourg, which the Luxembourg government said it would defend under European law. The European Union began a parallel process on harmful tax practices based on a Code of Conduct for Business Taxation. This applied similar criteria for harmful preferences, in a consensual approach through a Group of governmental representatives, although the alternative of legal action by the Commission under state aids rules could be available. The Code Group initially managed to identify and list potentially harmful measures, evaluating them and specifying the harmful ones which were to be phased out. Subsequently, states became more sophisticated in devising measures which could fall outside the criteria, particularly the ‘innovation box’ or ‘patent box’, which offers a low tax rate for royalties from intellectual property. The Group failed to agree that this was incompatible with the Code, which encouraged other countries also to adopt such a provision, notably the United Kingdom.

30 But see the Report of the Financial Stability Forum (FSF, 2000), where the list on users of offshore financial centres was headed by ‘International companies, to maximise profits in low tax regimes’ (p. 10); and Zoromé, 2007.

compliance with the FATF’s transparency standards was assimilated into the Standards and Codes initiative of the Financial Stability Forum and the Financial Sector Assessment Program of the IMF and WBG in 2002 (FSF [Financial Stability Forum], 2000). This remained separate from the tax transparency project of the OECD’s Global Forum, launched at that time, although they were both dealt with under the finance tracks of the G7/8 and of the G20.

There was some resistance to linking financial market supervision to tax issues, especially the inclusion of tax evasion or avoidance as a ‘predicate crime’ in AML legislation,³¹ or the sharing of information such as AML-suspicious transaction reports. Some financial supervisors considered that the difficulty of effective enforcement of information obligations on financial services providers in relation to money-laundering would be exacerbated if those obligations were extended to tax, since the lines dividing legal tax planning, illegal avoidance, and criminal evasion are often blurred, and both evasion and avoidance are widespread in many countries.

Financial centres themselves have generally been concerned to be seen to adhere to high standards of prudential supervision of financial institutions, to ensure financial stability and confidence, on which their continued attractiveness for deposits depends. So even those in poorer countries were mostly willing to strengthen their banking supervision capacity, and they proudly publicised their approval ratings resulting from the reviews of compliance with financial standards conducted by the FATF, IMF and WBG. However, financial centres have been reluctant to agree to transparency for tax purposes, indeed some were strongly resistant. This includes both offshore and onshore centres, as both have given higher priority to attracting portfolio capital inflows than to combating tax evasion, especially in other countries. This tension still remains, especially in US policies today (see below). Hence, tax evasion is linked to the issue of capital flight (Mbeki, 2015), although again both the distinct nature of the issues and their connection are not always made clear.

Financial centres were therefore able to pursue a policy of separating compliance with financial supervision standards (including AML) from providing information in tax matters, for which they continued to defend bank secrecy. The Global Forum made little progress, as the tax havens and offshore secrecy jurisdictions insisted on a ‘level playing field’, pointing to the refusal of OECD countries such as Luxembourg and Switzerland to relax bank secrecy in tax matters. The G7 summit in Birmingham in 1999 called for information gathered by money-laundering authorities to be shared with tax authorities internationally.³² Conversely, there are restrictions on sharing information obtained for tax purposes with other law enforcement agencies, which still need to be addressed.

31 The revision of the FATF standards in 2012 included the requirement that ‘predicate offences’ should include ‘tax crimes’; the term was not defined, but the standard requires that countries apply the crime of money laundering to all serious proceeds-generating offenses (IMF, 2014a, footnote 7).

32 This can be problematic even within a country, and procedures vary widely in practice: the Australian Tax Office officials have direct access to the large database of suspicious transaction reports; in other countries, tax officials must use a liaison point; in some, access is in practice not possible. A survey and recommendations were given in OECD, 2015a.

2.4 The financial crisis and the new G20/OECD agenda

A new impetus was created in 2008, initially for the work on tax transparency, by the financial crisis, the installation of the Obama administration, and revelations about the role of banks in Lichtenstein and Switzerland in tax evasion.³³ The Declaration of the Washington Summit on Financial Markets and the World Economy of November 2008 referred to the need to improve information-sharing from countries which had not committed to international standards in relation to bank secrecy. The Global Forum was restructured, and revised its approach to the listing of non-cooperative jurisdictions, adopting a threefold classification (non-compliant; partially compliant; fully compliant). This led to inclusion of OECD countries, Luxembourg and Switzerland, together with a number of other countries, on the grey list as partially compliant, albeit briefly.³⁴ The new approach was ringingly announced in the London Statement of the G20 leaders on 2 April 2009 with the assertion that '[t]he era of banking secrecy is over'. However, this was not backed up by specific actions. Under the French presidency in 2011, a new black list of tax havens was published which however had little political impact and was not even embedded in any formal process as was the previous OECD black list.

A more concrete breakthrough occurred with the enactment in the United States of the Foreign Account Tax Compliance Act (FATCA) in 2010, which entailed applying 'know-your-customer' obligations like those in AML standards for tax purposes. This aimed to ensure some effectiveness for the EoI obligations in TIEAs and DTAs since, unless financial providers are obliged to obtain information about the real owners of accounts, there would be little of worth to exchange. However, the United States itself had avoided collecting information on the accounts of non-resident foreign citizens (who are not US taxpayers), since the Treasury was concerned about the impact on portfolio investment into the United States. The FATCA standards quickly had a global impact. The US Treasury's programme of negotiation of bilateral intergovernmental agreements, to facilitate the application of these obligations to foreign banks wishing to do business in the United States, led to some reciprocity, although this was selective (Sheppard, 2012, 2013; Sullivan, 2009). Gradually, however, the FATCA created an upward ratchet on bank account transparency standards, and the links between tax evasion and avoidance also began to be better understood (Gravelle, 2015).

The momentum behind transparency continued, culminating in the G8 Lough Erne Declaration of June 2013. This called for a new global standard for the exchange of information for tax purposes, and a commitment to transparency for ownership of companies (see below). This was a qualitative shift, all the more notable for being led by

33 The information provided by 'whistleblower' Bradley Birkenfeld to the US authorities led to a deferred prosecution agreement with Swiss bank UBS involving a USD 780 million fine, announced in February 2009; and the list of bank accounts in Lichtenstein purchased by a German intelligence agency in summer 2007 led to high profile prosecutions there and in other countries between 2008 and 2009. On the other hand, Rudolf Elmer was prosecuted and jailed in Switzerland, having supplied details of transactions of global clients of the Cayman Islands affiliate of the Julius Bär Bank Group to the Swiss tax authorities; this was allegedly in breach of the Swiss Bank Secrecy law, though he was employed at the time by the Cayman Islands affiliate, eventually leading to his substantial exoneration on appeal.

34 This work was led at the OECD by Pascal St-Amans, who had been appointed in 2007 as head of the International Cooperation and Tax Competition Division.

the United Kingdom, which had long been criticised for protecting the large number of havens and secrecy jurisdictions that are UK dependencies. The G20 leaders in St Petersburg endorsed the mandate for the OECD to establish ‘a new single global standard for automatic exchange of information by February 2014’ (see Annex, point 4). The Common Reporting Standard (CRS) was approved by the OECD Council in July 2014, and by the G20 leaders in Cairns in September 2014, with a commitment to begin exchanging information automatically between each other and with others by the end of 2018 at the latest. So far, 101 countries have committed to implement the CRS, 54 of them by 2017, 47 by 2018. While this is a remarkable success against secrecy, concerns remain about the accurateness of the CRS (Knobel & Meinzer, 2014), and about the absence of the United States from the CRS due to their FATCA special regime (Knobel, 2016).

Meantime in the 2000s, the problem of MNE tax avoidance was even further exacerbated by a number of factors, including the virtual abandonment of the CFC rules by the United States³⁵ and other countries,³⁶ the emergence of internet-based MNEs, and the increase in tax preferences and special rulings, which had been little curbed by the measures against harmful tax practices. Increasing publicity began to be given to the problem of ‘stateless income’ and tax avoidance structures such as the ‘double Irish Dutch sandwich’, especially once the great financial crisis resulted in a fiscal crisis and austerity measures in many states. Growing public concerns had been reflected in the emergence of civil society organisations active on ‘tax justice’, which focused on tax avoidance by MNEs, its links to evasion and capital flight, and their effects especially on developing countries.³⁷ Tax had also come to be identified as a key issue for both governance and economic development in developing countries (Moore & Rackner, 2002).

The importance of tax in domestic resource mobilisation by developing countries was stressed at the Seoul Summit of November 2010, which adopted the G20 Multi-Year Action Plan on Development, designed to ensure inclusive and sustainable economic growth in developing countries and low income countries. Its pillar on Domestic Resource Mobilisation highlighted the need to develop more effective tax systems, and called for a joint report in 2011 from the OECD Task Force on Tax and Development, the United Nations, IMF, WB and regional organisations, as well as one from the Global Forum.³⁸ A

35 Due to the ‘check-the-box’ tax regulations issued by the Treasury Department in 1997, and the CFC ‘look-through rule’ first enacted as a temporary measure in 2006; see the report by Senators Levin and McCain, 2013, p. 13.

36 CFC rules of EU countries had to be reformed due to the ECJ decision in the Cadbury-Schweppes case (Case C-196-04, 2006, see Fontana, 2006. The United Kingdom, after some ambivalence (see Devereux, 2010), opted for an essentially territorial system in 2012.

37 The seminal report by Oxfam (2000) was followed by the founding of the Tax Justice network in 2003.

38 Under Action 1, the joint report was asked to: ‘Identify key capacity constraints faced by developing countries in their tax systems and make recommendations on capacity building to (i) improve efficiency and transparency of tax administrations and (ii) strengthen tax policies to broaden the tax base and combat tax avoidance and evasion (*June 2011*); Develop a knowledge management platform and promote South-South cooperation to support the capacity of developing countries in tax policy and administration systems (*Medium-term*); Survey and disseminate all G20 and international organizations’ actions on supporting tax systems in developing countries (*June 2011*); Set up objective measures to track progress in the capacity improvement of LICs’ [low income countries]’ tax administration systems (*June 2011*); and Identify ways to help developing countries’ tax multinational enterprises (MNEs) through effective transfer pricing. (*June 2011*). Action 2, to Support Work to Prevent Erosion of Domestic Tax Revenues, asked the Global Forum

joint report was produced (IMF, OECD (Organisation for Economic Co-operation and Development), United Nations, & World Bank, 2011), apparently after some friction between the organisations. It made a number of proposals focusing on ‘strengthening the enabling framework, as shaped by the G-20 countries, within which developing countries seek to raise their tax revenues in ways which promote state-building and a fair distribution of the tax burden’.³⁹ It also included a chapter on helping developing countries to tax MNEs through effective transfer pricing rules, which stressed the importance of an ‘internationally consistent approach’ based on the arm’s length standard, and proposed measures to try to make this effective, such as improved access to information and to data on comparables, and capacity building.

A more comprehensive approach to international tax reform only began to emerge in 2012. First, the communiqué of the G20 Leaders at Los Cabos, Mexico, in June 2012 stated: ‘We reiterate the need to prevent base erosion and profit shifting and we will follow with attention the ongoing work of the OECD in this area.’ A further push was given in the G8 Lough Erne Declaration of June 2013, the first four points of which were:

- Tax authorities across the world should automatically share information to fight the scourge of tax evasion.
- Countries should change rules that let companies shift their profits across borders to avoid taxes, and multinationals should report to tax authorities what tax they pay where.
- Companies should know who really owns them and tax collectors and law enforcers should be able to obtain this information easily.
- Developing countries should have the information and capacity to collect the taxes owed them – and other countries have a duty to help them.

This heralded a step change, in two respects. As regards the transparency agenda, it established the target of a new global standard for EoI: comprehensive, multilateral, automatic exchange of information for tax purposes, instead of patchy arrangements for bilateral exchange on request. It also pointed to the need to reinforce ‘know-your-customer obligations’ for bank accounts, to introduce transparency for ownership of companies and other legal persons. Secondly, it returned to the issue of tax avoidance, or profit-shifting, by MNEs.

2.5 The launching of the BEPS Project

The OECD began the project on base erosion and profit shifting (BEPS) almost immediately after Jeffrey Owens was succeeded by Pascal St-Amans as Director of the CTPA in February 2012.⁴⁰ He arrived with intentions to initiate reforms in several aspects of MNE

‘to enhance its work to counter the erosion of developing countries’ tax bases and, in particular, to highlight in its report the relationship between the work on noncooperative jurisdiction and development. (*Medium-term*)’.

39 A review of the progress made towards these was provided in 2016 (Platform for Collaboration on Tax, 2016, Appendix 1).

40 St-Amans was previously an official in the French tax administration (DGI) working on international tax, and member of the UNTC, before joining the OECD in 2007, where he became responsible for the ‘Harmful Tax Practices Project’ and head of the Global Forum Division.

taxation, especially transfer pricing and aggressive tax planning.⁴¹ However, a more ambitious perspective emerged from his first meeting with the Bureau of the CFA in March, which requested a fresh initiative, on base erosion and profit shifting, labelled BEPS. Approved by the CFA in June, this concept was submitted to the G20 at Los Cabos in June 2012 by St-Amans, and given their political support, as mentioned above.

The project was granted additional impetus by publicity in the United Kingdom to tax avoidance by MNEs such as Starbucks, Google and Amazon, at a parliamentary hearing in November 2012. This led the Chancellor of the Exchequer, George Osborne, to issue a statement with Germany’s Finance Minister Wolfgang Schauble at the G20 Finance Ministers’ meeting on 5 November, calling for concerted cooperation to close the gaps in international tax standards which were failing to keep up with changes such as developments in e-commerce (Houlder, 2012). It was followed by the offer of special funding for the OECD to do this work, from France, Germany and the United Kingdom. It should be noted however that the formulation of the BEPS initiative came from the OECD, and was not a response to the G20 concerns about tax and revenue mobilisation in developing countries. It was supported by G8 countries, but Pascal St-Amans had to overcome hesitancy from some G20 delegates (Brazil and China, at Deputy Finance Minister-level) who were not aware of the concept of base erosion, and initially wary of mandating the OECD, until they were more fully briefed by their tax specialists.⁴² Also, while the US delegate agreed to the launching of the project, the US participants were concerned throughout to resist proposals that stepped outside existing US rules or proposals of the current administration, and to defend US-based MNEs from stronger tax claims by source countries.

The initial report outlining the problem, ‘Addressing Base Erosion and Profit Shifting’, was approved by the CFA and published in February 2013. This argued that a holistic approach was needed, and proposed the rapid development of a comprehensive action plan. The Action Plan on Base Erosion and Profit Shifting, prepared by the CFA Bureau based on secretariat drafts, was presented to and approved by the G20 Finance Ministers in St Petersburg in July 2013. The G20 Leaders confirmed their approval at their September meeting, in a Tax Annex to the St Petersburg Declaration (see Appendix).

The work was delegated to be carried out through the OECD, which was able under its rules to allow participation of non-OECD countries in such a project ‘on an equal footing’, overcoming the reservations expressed by some G20 countries about the suitability of the OECD. Both they and the OECD countries made significant financial contributions to a special budget for the project. Reports on the 15 points of the Action Plan were to be

41 His message in the publication OECD’s ‘Current Tax Agenda 2012’ referred to work to ‘strengthen the rules on transfer pricing and provide better instruments to address base erosion and illegitimate profit shifting and to ensure both the elimination of double taxation and the avoidance of double exemption’.

42 The statement in the Los Cabos communiqué read: ‘We reiterate the need to prevent base erosion and profit shifting and we will follow with attention the ongoing work of the OECD in this area’, worded to avoid giving the impression that this was a new mandate. The OECD had also built some trust at the G20 with its work on transparency, and personal contacts due to the participation of its senior tax officials (Owens and St-Amans) since the two 2009 summits in the drafting of the tax aspects of communiqués, in the meeting of finance deputies, and the ‘jumbo’ joint meetings with ‘sherpas’.

delivered to the G20 within two years. There was also specific mention that developing countries must ‘reap the benefits’ of the G20 tax agenda.⁴³

3 The BEPS Project

3.1 The process

For the purposes of the BEPS project, the CFA was expanded to 44 countries (including the eight non-OECD G20 countries, and two OECD Accession countries, Colombia and Latvia). Halfway through the project it was agreed to extend participation to fourteen developing countries and, by the end, 60 countries had participated.⁴⁴ The work on the Action Points was carried out as far as possible through the existing Working Parties (WPs) of the CFA,⁴⁵ with the addition as new bodies of a Task Force on the Digital Economy (TFDE, for Action 1), and an ad hoc Group to develop the Multilateral Instrument for implementation of the BEPS measures requiring tax treaty changes (Action 15). This had the advantage that participants were already familiar with the issues, but the concomitant disadvantage that it made it difficult to think ‘outside the box’.

Progress reports were made, via their ‘sherpas’, to the G20 Deputies and Finance Ministers, and at key moments there were presentations to and discussions by the G20 leaders themselves. A first package of seven deliverables was submitted in September 2014 with a report (OECD, 2014), and the final package comprising thirteen reports on the fifteen Action Points was published on 5 October 2015, just before their presentation to the G20 Finance Ministers in Lima.⁴⁶

This was an outstanding achievement, as the detailed and complex proposals had to be negotiated in a very short timeframe, and required consensus among a very large number of participants. Nevertheless, the nature of the process undermined the cohesiveness and effectiveness of the final package. The political backing of the G20 at least helped to weaken obstructionism especially by non-G20 countries. G20 members were more able to hold out

43 However, the BEPS Action Plan explicitly stated that, although a number of countries had expressed concern about the existing allocation under DTAs of taxing rights between residence and source countries, ‘these actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income’ (OECD, 2013b, p.11).

44 Albania, Argentina, Australia, Austria, Azerbaijan, Bangladesh, Belgium, Brazil, Canada, Chile, Colombia, Costa Rica, People’s Republic of China, Croatia, Czech Republic, Denmark, Estonia, Finland, France, Georgia, Germany, Greece, Hungary, Iceland, India, Indonesia, Ireland, Israel, Italy, Jamaica, Japan, Kenya, Korea, Latvia, Lithuania, Luxembourg, Malaysia, Mexico, Morocco, Netherlands, New Zealand, Nigeria, Norway, Peru, Philippines, Poland, Portugal, Russian Federation, Saudi Arabia, Senegal, Singapore, Slovak Republic, Slovenia, South Africa, Spain, Sweden, Switzerland, Tunisia, Turkey, United Kingdom, United States and Vietnam (OECD, 2015b, footnote 2).

45 Mainly WP 1 (Tax Conventions) and WP 6 (Taxation of MNEs, that is, transfer pricing); WP 2 on Tax Policy Analysis and Statistics played a part in Action 11, WP 11 on Aggressive Tax Planning on Action 12, and the Forum on Harmful Tax Practices was responsible for Action 5.

46 All available at <http://www.oecd.org/tax/aggressive/beps-2015-final-reports.htm>. They are not specifically listed in the References, but mentioned in the text by reference to their Action Point number.

and defend their ‘red lines’, although at some key points senior OECD officials spoke directly to individual Finance Ministers to unblock obstacles.

A major difficulty was that the United States was a reluctant participant. US MNEs are the most aggressive users of tax avoidance techniques, partly because the nominal US tax rate has remained high (35 per cent), while the weakening of CFC rules and the ‘check-the-box’ entity classification regime have enabled or encouraged US-based MNEs to minimise the tax they pay on non-US profits and defer US tax on those profits by keeping them offshore. Resolving this problem would require a comprehensive US tax reform, but proposals could make no progress under President Obama with a Republican-dominated Congress. Hence, much in the BEPS reports was based on existing US rules, or formulated in a way to be compatible with them.⁴⁷

The government of the United Kingdom, while claiming to be a strong supporter of the project, also made clear early in the project that its negotiators would aim to support ‘fair tax competition’, and to retain the UK’s tax competitiveness (HM Treasury & HM Revenue and Customs, 2014). This explicitly included retaining the tax incentives introduced in 2012, the ‘patent box’, and revisions of the CFC rules. The UK’s defence of the patent box took up much of the work on Action 5 on Harmful Tax Practices, and the issue was only resolved by a compromise agreement between the United Kingdom and German Finance Ministers in November 2014.⁴⁸ The United Kingdom also, while the project was still under way in September 2014, issued draft legislation for a Diverted Profits Tax, which became law in April 2015. This technically highly complex legislation essentially threatens MNEs which have significant sales or other business in the United Kingdom with a higher rate of tax on profits transferred out of the United Kingdom through arrangements that could reasonably be considered as primarily aimed at avoiding tax, and which result in a reduction of 20 per cent or more of the overall tax that would have been payable. The target was evidently the profits of US MNEs accumulated offshore, so long as they remain untaxed by the United States. This was regretted as a unilateral move by both US and OECD officials, but could be seen as putting pressure on the United States and other countries whose rules were enabling some kinds of profit-shifting. It also suggested that the United Kingdom was not confident that the problems would be resolved by the BEPS project.

Some other powerful countries also attempted to safeguard their preferred measures. For example, the final proposals on limitation of interest deductions (Action 4) were formulated to be essentially in line with existing German rules. The final recommendations on CFC rules were very weak, suiting many states (including the United Kingdom which had effectively abandoned its CFC rules in 2012), although the US negotiators urged stronger measures. The revisions of the Transfer Pricing Guidelines continued to base these key rules on allocation of profit on general standards requiring assessment of functions, assets and

47 In a hearing before the House Ways and Means Subcommittee on Tax Policy on 1 December 2015, where he came under attack for having failed to consult Congress, the chief US negotiator Robert Stack stressed that he had taken care that the actions requiring Congressional approval (the proposals on interest deductibility and hybrid securities) were not treated as minimum standards in the final reports. Those proposals requiring treaty changes are brought together in the Multilateral Convention under Action 15, US adherence to which would require the consent of the Senate.

48 See Press Release: <http://www.bundesfinanzministerium.de/Content/EN/Pressemitteilungen/2014/2014-11-11-rules-on-preferential-ip-regimes.html>

risk, entailing subjective and discretionary judgments, which give ample scope for interpretation in different ways by both MNEs and national administrations.

The OECD made efforts at public consultation: 23 discussion drafts were issued, eliciting over 12,000 pages of comment, and 11 public consultations held (OECD, 2015b, p. 5). However, this consultation process was largely dominated by corporate tax advisers, who devoted considerable resources of time and expertise to it. The intensity of the process, and the highly technical nature of the issues, made a wider debate difficult. However, civil society organisations supported the creation of the BEPS Monitoring Group, an international network of researchers, which did succeed in submitting comments and participating in the consultations, though often as a lone voice amid the cacophony of the many MNE-paid advisors.

The importance of effective public debate and political accountability is shown in the main successful output from the project. This was the agreement on a template for country-by-country reporting by MNEs. This success was largely due to the strong support for it from civil society, and inclusion of a specific mandate in the St Petersburg Tax Annex. This called for a ‘common template for companies to report to tax administrations on their worldwide allocation of profits and tax’. However, negotiation of this issue was allocated to Working Party 6, consisting of specialists on transfer pricing, and the concept was initially assimilated into pre-existing ideas for a two-tier format for transfer pricing documentation. Following the public consultation, in which there was an exceptionally high level of civil society participation, the country-by-country reporting requirement was made distinct from the two tiers of transfer pricing documentation.

This also underscores the importance of the wording of the negotiating mandate, which for the BEPS project was formulated in the Tax Annex. Explicit wording obviously puts greater pressure on the actual negotiators to agree effective proposals. The Tax Annex also called for ‘more transparency between governments, with the need for countries to disclose rulings and other tax benefits to their partners, and disclosure by taxpayers of aggressive tax planning arrangements’, helping to ensure that such disclosure schemes were included in the final package.

3.2 The outcomes

This section will briefly summarise and evaluate the final report under each Action.

Action 1: Addressing the tax challenges of the digital economy

This was selected as the first Action Point, since a key motivation for the project was the concern of many countries at the increased avoidance resulting from digitalisation, especially for internet-based companies. The OECD had examined the tax implications of e-commerce in the period 1998-2006, resulting in only minor changes to international tax rules, and many considered that a reconsideration was overdue.

Unfortunately, the TFDE was unable to make any substantive proposals. The report provides an analysis of the problem, which differs in some significant respects from those produced by others. It outlines how the proposals in some of the other Action Points should

mitigate some of the problems. It then presents an analysis of three options which were put forward, which could be applied by states singly or in combination, to ‘reflect situations where an enterprise leverages digital technology to participate in the economic life of a country in a regular and sustained manner without having a physical presence in that country’ (Para. 276).

However, its conclusions were:

The options analysed by the TFDE to address the broader direct tax challenges, namely the new nexus in the form of a significant economic presence, the withholding tax on certain types of digital transactions and the equalisation levy, would require substantial changes to key international tax standards and would require further work. In the changing international tax environment a number of countries have expressed a concern about how international standards on which bilateral tax treaties are based allocate taxing rights between source and residence States. At this stage, it is however unclear whether these changes are warranted to deal with the changes brought about by advances in ICT. Taking the above into account, and in the absence of data on the actual scope of these broader direct tax challenges, the TFDE did not recommend any of the three options as internationally agreed standards. (Para. 357).

Countries would remain free to adopt any of these options, or indeed others, provided they respect existing treaty obligations, or could introduce appropriate provisions into their treaties. Some countries have quickly done so (see subsection 4.2 below).

The TFDE requested and was granted a further five years to continue its work to 2020. However, the German G20 presidency has included in its priorities (as of 1 December 2016) to ‘Launch a G20 discussion on the impact of digital technology on taxation’, and a report had been requested for the March 2017 meeting of Finance Ministers. This could obviously be very important, especially as it would be attended by the new US Treasury Secretary.

Action 2: Neutralising the effects of hybrid mismatch arrangements

These arrangements exploit differences in tax treatment of an entity (for instance, whether it is considered a partnership or a limited liability company) or instrument (usually a financial obligation, which may be treated as debt or equity) to avoid tax. The report is lengthy (450 pages), detailed and complex. It includes recommendations that states can consider for domestic law, and more lengthy proposals for treaty changes. These have now been included as options in the Multilateral Convention to Implement Measures to Prevent BEPS. Measures based on these have been proposed for adoption as a Directive in the European Union, currently under discussion. However, this is being delayed by the Netherlands, seeking a postponement on its implementation to 2024, following pressure from AmCham, a US MNE lobby group.⁴⁹

49 The Netherlands government position can be found at <https://www.rijksoverheid.nl/binaries/rijksoverheid/documenten/brieven/2016/11/18/bijlage-2-kamerbrief-inzake-informatievoorziening-over-nieuwe-commissievoorstellen/bijlage-2-kamerbrief-inzake-informatievoorziening-over-nieuwe-commissievoorstellen.pdf>, and the AmCham position at <http://www.amcham.nl/news/amcham%E2%80%99s-tax-committee-expresses-its-concerns-about-recent-proposals-european-commission>.

Action 3: Designing effective controlled foreign corporation rules

This report puts forward only recommendations, in the form of ‘building blocks’, for the guidance of states which may wish to adopt or revise CFC rules. This was a very weak outcome. Strong CFC rules, if adopted by a group of countries which are home to MNEs, could have been highly effective against BEPS behaviour. Such an approach would have support in the United States, and the US negotiators blamed others for refusing to support it. The weak rules proposed may in fact be damaging, since they in effect validate structures which fall outside the low thresholds they set. The EU’s Anti-Tax Avoidance Directive (ATAD) (Council Directive 2016/1164) included provisions based on these recommendations.

Action 4: Limiting base erosion involving interest deductions and other financial payments

This had the potential to result in highly effective proposals, since excessive deductions of costs such as interest and royalties are a key method used for tax avoidance by MNEs. The work on this Action dealt only with interest costs. The finance function is generally highly centralised within a MNE group, which can borrow cheaply on international capital markets on the strength of the creditworthiness of the group as a whole, but finance affiliates within the group with debt requiring interest payments that may be far in excess of its consolidated net interest costs. The Discussion Draft initially put forward under this Action proposed measures which would have been very effective, by limiting the overall deductibility of interest costs of a group as a whole to its net consolidated interest expense, allocated among its affiliates according to a measure such as EBITDA (earnings before interest, tax, depreciation and amortisation). This approach was supported at a closed consultation meeting with academics and others, but strongly resisted at the public consultation by business representatives.

The final report greatly weakened the proposal, by recommending a fixed cap for interest deductibility of between 10 per cent and 30 per cent of EBITDA, combined with a ‘group ratio rule’ (that is, the apportioned consolidated interest cost) – but at the option of the taxpayer. This could nevertheless be better than the other main method used in many countries – ‘thin capitalisation’ rules – which have generally been easy for MNEs to avoid. It would be especially effective if states opted for the low 10 per cent cap.⁵⁰ However, they are very unlikely to do so, for fear of discouraging inward investment. Not surprisingly, the EU’s ATAD (2016/1164) adopted the 30 per cent cap. This approach will continue to allow MNEs to arrange intercompany debt on which deductible interest costs will be far in excess of consolidated net interest costs.

50 Data put forward by business groups themselves showed that there are wide variations in the debt ratio between economic sectors and even between different firms. A survey for the period 2009-2013 showed that 55-61 per cent of non-financial MNEs had interest expense below 10 per cent of EBITDA, and 78-83 per cent had a ratio below 30 per cent (BIAC [Business and Industry Advisory Group], 2015, p. 136).

Action 5: Countering harmful tax practices more effectively, taking into account transparency and substance

This Action revived the Forum on Harmful Tax Practices established by the 1998 initiative, discussed in subsection 2.2.2 above. It worked on two issues:

- i) Strengthening the criteria for what constitutes a harmful regime, by developing a substantial activity requirement and applying it initially to intellectual property (IP) regimes, and
- ii) establishing a framework for notification of tax rulings among tax authorities.

Both the OECD’s Forum, and the EU’s Code of Conduct Group which applied similar principles, had soon lost momentum after 2001 and proved ineffective at limiting the spread of increasingly sophisticated preferential schemes, sometimes also obscured by private rulings (see, for example, Dirix, 2013, on six Belgian schemes). These problems were exemplified by the spread of IP schemes.

IP regimes go beyond the usual often generous allowances to deduct expenditure on research and development by allowing a lower tax rate on income from IP. Since a very common form of tax avoidance is to transfer ownership of IP rights to entities subject to low tax rates, such schemes raise concerns that they facilitate BEPS. In the European Union, France introduced such a regime in 2000 and Hungary in 2003, but greater attention was attracted by the schemes introduced by the Netherlands and Luxembourg in 2007, after which they became more generous and spread to 8 more countries, including the United Kingdom in 2012 (Evers, Miller, & Spengel, 2014).

The European Commission found the United Kingdom’s patent box contrary to the Code in 2014, since it did not require that either the development or management activities relating to the IP must take place in the United Kingdom. However, the Code of Conduct Group could not agree, and left the issue for negotiation in the BEPS project. The OECD Forum spent much of the first year of the BEPS project on refining the substantial activity or ‘nexus’ test, focusing especially on the UK patent box, but the issue had to be resolved by an agreement between the German and UK ministers in November 2014. The CFA accepted this ‘modified nexus test’, which was adopted in the Action 5 Report as a general ‘substantive activity’ requirement.

The Report on Action 5 reaffirmed the criteria and procedures for evaluating harmful tax practices, including agreement that if a measure is found harmful, the country concerned is given the opportunity to abolish it or bring it into line, while others may apply counter-measures until this is done. The expanded substantive activity requirement now specifies that IP regimes can apply only to patents and functionally equivalent types of IP. The income benefiting from the tax advantage must be proportionate to ‘qualifying expenditures’ (although a 30 per cent ‘uplift’ was allowed, as agreed between Germany and the United Kingdom). These expenditures must be incurred by the person or entity receiving the tax benefits, and be directly linked to the relevant patent. The application of these conditions in practice needs complex regulations, and requires companies to ensure ‘track and trace’ of the expenditures in their accounts.

The Forum applied this new criterion to 16 existing IP measures, and found them all at least partially non-compliant (BEPS Action 5, report paras. 147-148). Some states quickly took

steps to revise their measures, including the United Kingdom. At the same time, other states have introduced new patent boxes (Ireland, Italy, Switzerland) and there has been pressure for such measures elsewhere (Germany, United States). This shows the danger of this approach based on consensual evaluation by government representatives: they are naturally reluctant to veto each other's initiatives, and a measure which is not found invalid is likely to be imitated.

The report stated that a further 27 non-IP regimes had been evaluated, and were all found not harmful, or potentially but not actually harmful, except three (from Switzerland) which were in the process of being eliminated. The report also discussed the application of the substantial activities criterion to other schemes, such as headquarters regimes, to show how a link would need to be shown between performance of the relevant activities and the income benefiting from the regime. However, each actual regime still needs to be evaluated specifically in more detail, based on the criteria, in the continuing work of the Forum.

The report also provides a framework for 'compulsory spontaneous' information exchange of tax rulings which might give rise to BEPS concerns, within the framework of the exchange of information provisions in tax treaties. The European Union has enacted a legal framework implementing such a procedure in Directive 2015/2376 of 8 December 2015.

This Action is considered to be a minimum commitment for all BEPS participating countries, and a peer review process to monitor compliance is being established for them and other jurisdictions 'of interest'.

Action 6: Preventing the granting of treaty benefits in inappropriate circumstances

This aims to prevent abuse of tax treaties, especially treaty shopping. It provides for:

- i) Changes to the title and preamble of DTAs to provide a clear statement that the aims of the agreement are to eliminate double taxation 'without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance (including through treaty shopping arrangements aimed at obtaining reliefs provided in this Convention for the indirect benefit of residents of third state)', together with related changes to the Commentary;
- ii) two types of anti-treaty-shopping articles to be included in DTAs: a) a 'simplified' limitation-on-benefits (SLoB) provision (which is actually quite complex, although simpler than the US-inspired detailed LoB rules), and b) a general principle purpose test (PPT); states may choose between a combination of the SLoB and the PPT, a PPT alone, or may adopt their own more detailed LoB article plus a mechanism to deal with conduit financing arrangements (see further under Action 15 below);
- iii) four specific anti-abuse rules for inclusion in DTAs; and
- iv) two rules to deal with the interaction of DTAs and domestic anti-abuse rules: a) to clarify that treaties do not restrict the right of states to tax their own residents (subject to specified exceptions), and b) to permit so-called 'departure' or 'exit' taxes.

These are considered to be minimum commitments for all BEPS participating countries. Provisions allowing rapid implementation are included in the Action 15 Multilateral Instrument (MC-BEPS). The SLoB provisions are highly detailed and technical, and were

included mainly at the insistence of the United States, which regards the PPT, that is favoured by EU and most other states, as allowing too much discretion. It should be possible, through the MC-BEPS, for these changes to be adopted quite quickly between states which prefer a PPT, although there may be some reluctance on the part of some states which have been used for treaty-shopping (such as Mauritius, the Netherlands, Singapore and Switzerland). Implementation by the United States will be more problematic, especially as indications are that the United States may not join the MC-BEPS, preferring to amend its treaties bilaterally. Since this is a minimum commitment, compliance should be monitored via peer-review (discussed further below).

Action 7: Preventing the artificial avoidance of permanent establishment status

Under DTAs, a foreign resident entity is only taxable on its business profits in a country if it has a Permanent Establishment (PE) there, essentially requiring a specific physical place with a degree of permanence (normally 12 months in the OECD and 6 in the UN model). This report puts forward some specific modifications to the definition of a PE in Article 5 of the models, and related parts of the Commentary. These are:

- i) An amendment to Article 5 to specify that an agent which ‘habitually concludes contracts or habitually plays the principal role in the conclusion of contracts’ may constitute a PE for its principal, unless it is unrelated to the foreign principal and acts in the ordinary course of business as an independent agent;
- ii) an amendment to clarify that the exceptions in Article 5(4) of the model convention (which exclude activities such as warehousing) apply only if these activities are of a ‘preparatory or auxiliary’ character;
- iii) a provision specifying that the ‘preparatory or auxiliary’ condition cannot be avoided by fragmenting complementary functions that are part of a cohesive business conducted by an enterprise and one or more other related enterprises; and
- iv) amendment of the Commentary to specify that the PPT anti-abuse rule can apply if the PE test in relation to construction sites is avoided by splitting contracts into successive shorter periods.

Provisions to implement these changes are rapidly included in the MC-BEPS. However, this Action is not one of the minimum commitments, and a state may opt out of any or all of these provisions of the MC-BEPS. Thus, states which desire inclusion of these changes in their DTAs may need to negotiate them with their treaty partners.

Even if these changes are adopted, much depends on the rules for attributing profits to a permanent establishment (PE), which are in Article 7 of DTAs. The implications of the changes to the PE definition for the attribution of profits to such a PE was one of the issues left for further work in the BEPS project. A Discussion Draft on this was issued for comments in July 2016 and discussed in a public consultation in October, but no revised draft or report has yet been issued. That Draft was predicated on an amended version of Article 7 adopted by the OECD in 2010, establishing the so-called Authorised OECD Approach (AOA) to attribution of profits to a PE. The AOA aims to treat a PE for these purposes as far as possible as if it were an associated enterprise (that is, separately incorporated), and to apply the arm’s length principle of transfer pricing used in Article 9

of DTAs. The AOA is not accepted by some OECD members, and was rejected by the UNTC and most developing countries.

This issue of attribution of profits to a PE remains to be dealt with, and countries which join the BEPS Inclusive Framework would be entitled to participate in this work.

Actions 8, 9, 10: Aligning transfer pricing outcomes in line with value creation

These adopted extensive revisions and additions to the OECD Transfer Pricing Guidelines (TPGs), which specify the principles and methods that may be used under Article 9 of DTAs to adjust the accounts of associated enterprises, according to the ‘independent entity’ principle (often referred to as the ‘arm’s length principle’). The BEPS Action Plan stated that these Actions would include consideration of whether there is a need for ‘special measures’ going beyond the arm’s length principle. The initial discussion draft included some such proposals, but none was adopted.

The final report adopted revisions and additions to the TPGs, as follows:

- i) Revisions to Section D of Chapter I, to identify and delineate the actual intercompany transactions that should be the base for setting arm’s length prices, also allowing tax authorities on a limited basis to recharacterise transactions between associated enterprises, providing guidance for the analysis of the actual functions performed and risks assumed, emphasising control of those functions and risks and having the financial capacity to assume them; the aim being to end the attribution of significant income to affiliates existing largely on paper which do not have the capacity to exercise those functions or assume those risks; however, what constitutes control or capacity is not specified;
- ii) the inclusion in Section D of Chapter I of provisions to allow adjustments to reflect a) location savings, b) other local market features (such as size and rate of growth), c) existence of an assembled workforce with unique features, and iv) MNE group synergies; these concepts were considered important by China and India;
- iii) additions to Chapter II specifying that, for transactions involving physical commodities, reference can be made to published prices quoted on a relevant exchange, with appropriate adjustments for factors such as quality, volume, and the timing and terms of delivery; this assimilates into the OECD arm’s length principle the so-called ‘sixth method’ of transfer pricing, which originated in Argentina and has been adopted in some other developing countries especially in Latin America;
- iv) a revised version of Chapter VI, dealing with the key issue of intangibles, mainly to emphasise the requirements of control and capacity to perform the functions of ‘development, maintenance, enhancement, protection, and exploitation’ (DEMPE) of intangibles, and that provision of funds without more would justify only a risk-free return on those funds; also, revised methods to deal with hard-to-value intangibles;
- v) a revised version of Chapter VII, which deals with charges for intra-group services among members of a MNE group, to allow for a simplified method in relation to low-value-adding services (for instance, accounting, human relations, IT, communications and PR, legal and tax administration), to pool and allocate the costs based on factors

reflecting the need for and benefit received from the service, though also unexpectedly allowing for a 5 per cent ‘uplift’ on such low-value-adding service costs; and

- vi) revisions to chapter VIII, which deals with cost-contribution arrangements, to provide that they should be analysed based on the actual functions performed and risks assumed by the parties, and not on ‘contractual terms that do not reflect economic reality’; also restricting CCA participants to persons that actually have the capacity to understand and control the risks.

These constituted extensive revisions and enlargement of the TPGs. However, they only continued and reinforced the existing approach based on the independent entity principle, which was expressly not reconsidered.

The Action Plan also called for work which would break new ground, on the application of transfer pricing methods, especially the ‘profit split’ method, ‘in the context of global value chains’. A discussion draft was issued which received extensive comments and a public consultation, but this work was not concluded. The profit split method is the most controversial of the five approved methods, as it involves aggregation of the profits of related parties and their allocation among associated enterprises based on relevant allocation keys, rather than adjusting their accounts by reference to comparable prices or comparable profits among unrelated parties, as do the other four approved methods. The final report included a section outlining the scope of further work on the profit split method. A consultation document was issued in July 2016, and a public consultation was held in October, but no revised document has yet been issued. A Toolkit to help developing countries deal with the problem of comparables is also being prepared by the Platform.

Action 11: Measuring and monitoring BEPS

This outlined and analysed the available data and methods for evaluating the effects of tax avoidance by MNEs (BEPS practices). It suggested that these have caused growing revenue losses, now estimated at between 4 per cent and 10 per cent of global corporate income tax revenues, that is, USD 100 to 240 billion annually. Due to developing countries’ greater reliance on such revenues, the impact on such countries as a percentage of gross domestic product (GDP) is higher than for developed countries. It also pointed to the other adverse economic effects, notably in distorting competition and the international allocation of investments, and wasteful spending on tax engineering. Recognising the inadequacy of existing studies, it made recommendations for improved use of available data, especially those available to tax administrations, subject to appropriate safeguards for confidentiality. It pointed especially to the potential benefits of analysing the data which should result from country-by-country reporting (Action 13) to measure the extent of BEPS and monitor the effectiveness of actions to counteract such practices.

Action 12: Mandatory disclosure rules

This provides a framework which countries could use to establish rules for mandatory disclosure to enable them to obtain early information on potentially aggressive or abusive tax planning schemes and their users. They are based on schemes developed in some countries, such as the United Kingdom, with some refinements to target international avoidance schemes. The report also includes proposals for more effective information

exchange and co-operation between tax administrations to deal with such schemes, based on the JITSIC Network.

Action 13: Transfer pricing documentation and country-by-country reporting

This report establishes agreed templates for country-by-country reports and for transfer pricing documentation. These will, for the first time, provide all interested tax authorities with a clear overview of MNEs as a whole, as well as details of the relationships between the different parts. The scheme takes effect as a chapter of the OECD TPGs, supplemented by additional reports on details of its implementation.

Under this scheme, country-by-country reports will be required only for the largest MNEs (group consolidated revenues higher than EUR 750 million), at least until the scheme is reviewed in 2020. They should be filed with the tax authority of the MNE's parent country, and shared with others subject to confidentiality and appropriate use protections. In particular, the scheme insists that they should be used only for risk evaluation, and not as a basis for formulary apportionment. Sharing is through exchange of information under a suitable tax treaty, and a special Competent Authority Agreement. These arrangements for dissemination create obstacles, especially for developing countries. Various proposals have been made for publication of such reports, which is strongly supported by civil society, and by some MNEs, especially as similar transparency requirements already exist in the banking and oil and gas sectors.⁵¹ However, a uniform global scheme would require support from the USA.

In contrast to the country-by-country report (CbCR), the Master File for transfer pricing documentation should be delivered to all relevant tax authorities directly, together with a specific country Local File. These can be required from any firm (no specified size limitation) with a taxable presence in more than one country. They will provide significant detail facilitating audit, especially of transfer prices. Countries will need to enact legislation to enable their tax authority to obtain this information. This may go beyond the agreed template, as is the case for the regulations recently confirmed by China.

Action 14: Making dispute resolution mechanisms more effective

This was regarded as a high priority Action Point by business representatives. Data collected by the OECD since 2006 show a continued increase in tax conflicts resulting from divergent interpretations of treaty provisions, as well as an increase in the time taken to resolve them. Treaties allow a taxpayer affected by such a conflict to bring a claim to the 'competent authority' in its state, which must either resolve it unilaterally or take it up through the mutual agreement procedure (MAP) with the competent authority of the other state concerned. The tax treaty provisions say that the competent authorities must 'endeavour' to resolve the conflicts, but they are not obliged to do so. MNEs have long pressed for a binding

51 In the European Union under the Accounting and Transparency, and the Capital Requirements Directive IV, and in the US Dodd-Frank Act, section 1504 (implementation of which has been blocked by legal actions.) Momentum for public country-by-country reports is growing, especially in the European Union, where it has been proposed as a corporate disclosure rather than as a tax measure. The UK Parliament in 2016 enacted a provision authorising publication, if other countries agree.

obligation to resolve such disputes. The MAP is essentially an administrative procedure, and is in addition to the normal legal procedures available to enforce tax treaty rights, so in some states the taxpayer must choose between the two. As an administrative procedure, the MAP is covered by confidentiality, and even the existence of a case is not revealed; hence it is often preferred by taxpayers as an alternative to resorting to litigation in courts, where proceedings are generally to some extent public.

The report establishes some minimum standards which aim to improve the availability, transparency and effectiveness of the MAP for the taxpayer. These include a commitment to seek to resolve MAP cases within 24 months, and ensuring that staff dealing with the MAP operate independently of audit staff and are not subject to policy direction. It also provides a number of ‘best practices’, including accepting the obligation in Article 9(2) of the model convention to resolve economic double taxation, implementing a programme of bilateral advance pricing agreements,⁵² and accepting that, even if a court finds an administrative decision compatible with the treaty, discretionary relief could be given via the MAP. Some of these entail changes to the text and/or Commentary of the model convention.

Implementing these enhancements of the MAP will place significant strains on tax administrations which everywhere are short of staff, especially in poorer countries. International tax, especially transfer pricing, requires special skills – and tax administrations are generally no match for the legions of tax advisers.⁵³ It is asking a lot to expect them to find additional special staff to deal with MAP claims, separate from frontline audit staff. Also, audit staff are generally expected to work in line with the general policy set by senior transfer pricing officials, and it is not clear whether the concept of separation requires the competent authority to be distinct from such senior policymakers. The aim seems to be to create a closed community of MAP specialists who could more easily agree among themselves on how to apply the discretionary and subjective rules. This would further reinforce orthodox approaches in the dominant OECD countries, and marginalise or exclude alternative perspectives, such as Brazil’s fixed margin method, or concepts such as location savings or value chain analysis favoured by China and India.

The report also stated the commitment of 20 states, all OECD members, to accept mandatory binding arbitration of unresolved MAP disputes. This has been urged by business since the 1930s, but rejected by states until the 1990s. An EU Convention has been in force since 1995, providing for unresolved transfer pricing conflicts to be referred to an ad hoc Commission for a reasoned opinion, which can be published if the parties agree (none has yet been published). According to data from the European Commission, only 5 or 6 cases have actually been referred to arbitration; supporters of arbitration regard this as a success, since the aim is to put pressure on the competent authorities to resolve conflicts by compromise. The United States introduced a ‘short-form’ or ‘baseball’ arbitration procedure

52 These give prior approval of a MNE’s transfer pricing, binding both the taxpayer and tax authority, provided their conditions are complied with, usually for some 3-5 years.

53 A recent Handbook published by the WBG states: ‘Where a focus on strengthening transfer pricing regimes is justified, it is important to manage expectations carefully. Building commensurate administrative capacity for transfer pricing is not a short-term endeavor. Country experience suggests that institution building for effective audit activities focused on transfer pricing takes a minimum of 3–5 years’ (Cooper, Fox, Loeprick, & Mohindra, 2016, p. xix).

in its treaties with Canada and Germany ten years ago. Under this method, the arbitrators can only choose between the ‘last best offer’ tabled by the parties; they are prohibited from giving reasons, and their decisions must not be used as precedents in other cases. The OECD model has since 2007 included a provision for arbitration at the request of the taxpayer, and the UN model since 2011 includes a version at the request of one of the competent authorities. Some 200 treaties now include one of these versions, a few with developing countries.

However, developing and emerging countries are generally firmly opposed to mandatory arbitration, especially those such as India which have had a bad experience with arbitration of investment disputes, some of which have involved tax issues (for further details, see Picciotto, 2016). The UNCTC has established a subcommittee on the prevention and resolution of disputes, which is exploring alternative dispute resolution mechanisms. The real need is for rules which are clearer and easier to administer, to reduce the scope for conflict.

The multilateral instrument (MC-BEPS) developed under Action 15 includes a chapter providing for mandatory binding arbitration (see below). States must opt in if they wish to adopt this, but they may choose between the ‘baseball’ model (which is the default option), or the ‘reasoned opinion’ model. In October 2016, the European Commission published a proposal for a Directive on mandatory resolution of tax disputes, which specifies an Advisory Commission using the ‘reasoned opinion’ model, although it allows the competent authorities to agree an alternative, which may be the ‘baseball’ version.

Action 15: Developing a multilateral instrument to modify bilateral tax treaties

This reproduced the report published in the 2014 package. It outlined the need for and the nature of a multilateral instrument which would facilitate the rapid implementation of the changes to tax treaties recommended in the BEPS reports. Those changes took the form of revisions of the OECD model convention and its Commentaries, but reliance on the usual procedure of using the model for bilateral negotiations to amend existing treaties would obviously delay the implementation by many years.

On the basis of the 2014 report, and with the support of the G20 Finance Ministers’ meeting of February 2015, an Ad Hoc Group was established to prepare the instrument. It was open to all interested countries, and 99 countries participated, as well as four non-state jurisdictions and seven international or regional organisations as observers. It established a sub-group to formulate the arbitration provisions. The text of the MC-BEPS, as well as an Explanatory Statement, were published on 24 November 2016.⁵⁴

The MC-BEPS is a self-standing convention which will operate alongside existing DTAs, while applying to modify many of them, although in different ways according to the choices made by states. It is accompanied by an Explanatory Statement, but does not have a Commentary as do the model conventions. Instead, the reports on the relevant Actions in

54 A detailed analysis by the BEPS Monitoring Group is available at <https://bepsmonitoringgroup.files.wordpress.com/2017/03/explanation-and-analysis-of-mc-beps-final-rev.pdf>.

the BEPS project will be used as aids to interpretation.⁵⁵ It is drafted in such a way as to allow modification of any version of the existing treaty provisions, whether based on the OECD or UN models, or indeed on neither. It includes provisions enabling countries to meet the minimum standards commitments, as well as some reflecting recommended common approaches (see next section). It attempts the difficult task of aiming at consistency, while allowing sufficient flexibility to accommodate the positions of different countries. States joining the convention may opt-out of specific provisions only by making any of the defined permitted reservations, which must apply without discrimination to all other parties.

The provisions on mandatory binding arbitration will apply only for states which opt in to them. It is also possible to make free-form reservations on the scope of these provisions.

The core provisions are those against treaty abuse and treaty shopping, which are minimum standards. Most participating states are likely to accept the general principle purpose test (PPT) in Article 7(1). However, they may choose to combine this with the so-called simplified limitation of benefits provisions in Article 7 (8-13). If they do not wish to apply the SLoB themselves, they may nevertheless agree to allow another contracting party which accepts the combined PPT and SLoB to do so. A participating state may opt out of the PPT in Article 1 if:

- i) The other participating country does not accept the SLoB (bilaterally or unilaterally), or
- ii) it intends to adopt its own detailed LoB provisions together with either a PPT or rules against conduit financing; in this case, the participating countries must try to agree on something which meets the minimum standard.

These complex provisions regarding the LoB alternatives were included mainly to accommodate the United States, which rejects a PPT approach on the grounds that it is too subjective. However, the effect is to permit a state such as the United States to opt out of the PPT in Article 1 on the basis of an undertaking to negotiate bilaterally with other countries on an alternative which meets the minimum standards.

The convention is open for signature by all states. On signature, states must specify – at least provisionally – their reservations and notifications. This allows a period for discussions with others in order to facilitate matching commitments, since unless both parties to a DTA make the same commitment the relevant treaty provision will not be modified. Reservations can be withdrawn at any time, but cannot be added to after a state ratifies the convention. The OECD hopes to facilitate matching informally, and organised a meeting in February 2017 for countries to meet bilaterally in order to facilitate matching of offers. A formal signing of the convention is planned for June 2017. The convention will enter into force after five states have ratified it. States may withdraw at any time, but changes made to DTAs will remain in effect until the DTA is renegotiated. The OECD will publish documentation to clarify which DTAs have been amended and how, and will assist states in dealing with language issues (the MC-BEPS has official versions only in English and French), and to prepare consolidated versions of the revised treaties.

55 An Annex of the Explanatory Statement identifies the reports which are relevant to each of the treaty articles.

4 The post-BEPS Project agenda

4.1 Remaining issues and the inclusive framework

As is clear from the overview of the BEPS reports in the previous section, the BEPS project is far from over. The emphasis in this next stage is obviously on ensuring effective, widespread and coherent implementation. In addition however, some key issues remain unresolved, and work is continuing on these. Finally, all this will be taking place in a very fluid context of changes in corporate tax law and its enforcement, especially by key actors such as China, the European Union, India, the United States and the United Kingdom. These issues will be discussed in this section. The overarching question is the developing dynamic and future of global tax governance, which will be discussed in the next section.

Completing the Action Plan was a significant achievement, but implementing its outcomes will be even more challenging. In fact, the BEPS project will continue to dominate the international tax arena for the next few years. The OECD and G20 are committed to continuing their cooperation on BEPS at least to 2020 (OECD, 2015b, p. 11).

First, there is the complex process of adoption of the various new rules into international and national law. Secondly, implementation will be a continuing process, due to the nature of many of the measures. Most of the actions consist of attempting to strengthen existing rules, and many rely on the application by tax authorities of general rules and principles which leave wide room for interpretation, such as the principle purpose test (Action 6), or the criteria of ‘control’ and ‘capacity to manage’ in transfer pricing. Anticipating a period of increased uncertainty and conflict, the MAP is supposed to be strengthened, but this will need additional resources which it will be difficult for tax administrations to find.

Tax competition between states has not been ended, and in some respects is being exacerbated. Competition to increasingly lower corporate income tax rates is accelerating. It has been led by peripheral EU countries such as Ireland and Cyprus (12.5 per cent) and Bulgaria (10 per cent), but then followed by large economies, notably the United Kingdom (where it was 52 per cent in the 1980s, and has been cut from 28 per cent in 2010 to 20 per cent, with a commitment to go to 17 per cent by 2020), and now the US (where the Trump administration has announced its aim as 15 per cent).

The other side of the coin is competition over tax base definition, by offering selected incentives. The only check on the ingenuity of those who like to devise new tax incentives, such as patent box and similar regimes, will be the ‘peer review’ procedure of the Forum on Harmful Tax Practices. Its effectiveness will depend on political support, which may be hard to sustain: the loss of momentum experienced when President Bush arrived in the White House in 2001 (see subsection 2.2.2 above) may be repeated with President Trump. The tightly controlled dissemination of CbCRs will make any public evaluation of the effectiveness of the reforms difficult or impossible.

To manage this process, an Inclusive Framework was set out by the OECD and approved by the G20 Finance Ministers in Shanghai in February 2016. This extends participation in the CFA to ‘all interested and committed countries and jurisdictions, bringing them on an equal footing with the G20 and OECD countries, on both the BEPS standard setting and BEPS implementation monitoring’. In addition, countries which do not choose to commit, but which are considered ‘relevant for ensuring a level-playing field in tackling BEPS issues

globally’ would also be subject to review (OECD, 2016b, p. 9). The BEPS Associates which join the Inclusive Framework will be required to make the same commitments as others, and will also be able to participate in the continuing work on standard-setting. They will contribute to the budget for this work, on a sliding scale. The BRICS countries (Brazil, Russia, India, China and South Africa) welcomed the establishment of the Inclusive Framework and appealed to all other countries to join and participate in the BEPS project, at a meeting of their Heads of Revenue in Mumbai in December 2016.⁵⁶

Regional meetings were organised through the OECD’s Global Relations Programme to explain the Inclusive Framework, in Dakar (February 2016), Montevideo (September 2016), Tunis (November 2016), Manila (November/December 2016), and Vilnius (December 2016). The first meeting of the Inclusive Framework was held in Kyoto in June 2016; by December 2016 it had over 90 members, and the OECD expected to have one hundred by the time of its plenary meeting at the end of January 2017.

4.2 Implementation of the BEPS outcomes

The outcomes in the final package have been placed in three categories⁵⁷

- i) **Minimum Standards**, dealing with cases where inaction by a country could create negative spill-overs, so that participating countries have agreed to commit to consistent implementation: combating Harmful Tax Practices (Action 5), preventing treaty shopping (Action 6), ensuring Country-by-Country Reporting (Action 13), and improving dispute resolution (Action 14).
- ii) **Common Approaches**, to facilitate convergence of national practices: transfer pricing (Actions 8, 9, 10), changes to the Permanent Establishment definition (Action 7), limiting the deductibility of interest expense (Action 4), and neutralising hybrid mismatch arrangements (Action 2).
- iii) **Guidance** drawing on best practices, which countries may adopt if and as they choose: mandatory disclosure by taxpayers of aggressive tax schemes (Action 12) and Controlled Foreign Corporation (CFC) rules (Action 3).

As part of the BEPS package, it was agreed that there should be a process of monitoring of the implementation and impact of the measures. This will take the form of ‘assessment of compliance in particular with the minimum standards in the form of reports on what countries have done to implement the BEPS recommendations’, involving ‘some form of peer review which will have to be defined and adapted to the different Actions, with a view to establishing a level playing field by ensuring all countries and jurisdictions implement their commitments so that no country or jurisdiction would gain unfair competitive advantages’ (OECD, 2015b, p. 10).

This monitoring process will take place through the Inclusive Framework, and focus especially on implementation of the four minimum standards, which will be done by peer

56 However, the Press Release from India’s Central Board of Direct Taxes also referred to ‘the role of United Nations in becoming the voice of developing and emerging economies in setting international tax rules’.

57 See the Explanatory Statement issued with the BEPS package, para. 11.

review. The first peer review mechanism, dealing with the Action 14 measures for improving dispute settlement, to be done through the FTA's MAP Forum, was outlined in a report of October 2016. This set out the terms of reference and assessment methodology for Action 14, a reporting framework for MAP statistics, and guidance on submission of requests for MAP assistance. The Forum on Harmful Tax Practices will presumably set out its own peer review procedures, while mechanisms are also to be established for Actions 6 (anti-treaty-abuse) and 13 (country-by-country reporting).

At the international level, changes to DTAs will be facilitated by the MC-BEPS, especially relating to Actions 6 and 14, which are minimum commitments. Nevertheless, the flexibility the Convention means that the treaty network will remain varied, and in some respects the MC-BEPS itself adds an additional layer of complexity. Its provisions are highly technical, and understanding it is especially difficult for those who do not have as their first language English or French, the only official languages in which it has been issued.⁵⁸ Some – especially developing countries – may find it hard to choose which provisions are best suited to them. Developing countries, most of which have not been involved in the BEPS project, may be reluctant to adopt provisions which they have not been involved in formulating. A number are already reviewing their existing treaties, and may wish to suspend and/or renegotiate them. Also, some OECD states may be unwilling to adopt it, at least initially, notably the United States. Even some of the leading proponents of the convention, such as the United Kingdom, may be selective in deciding which changes to adopt (apart from the minimum commitments). All these hesitations could undermine the comprehensiveness of implementation of the BEPS project recommendations. The OECD plans to create supporting material to enable tracking of the various reservations made by states which join the convention. It will also act as the Secretariat for the convention, and organise any Conference of the Parties which may be called.

Implementation at the national level will be very uneven. A number of OECD states began implementation of some of the measures even before the final reports were issued, notably those on hybrid entities and instruments. Within the EU, a rapid and harmonised implementation was achieved of the transparency measures: compulsory exchange of tax rulings,⁵⁹ and country-by-country reporting.⁶⁰ The first anti-tax-avoidance directive (ATAD 1),⁶¹ also achieved a harmonised implementation of rules on limitation of interest deductions, CFCs, and hybrid mismatches between EU states, although at the cost of adopting low standards for the first two. In other areas states have diverged, notably in relation to tax incentives, such as 'patent boxes'. Some have legislated to bring their patent box at least formally into line with the 'modified nexus' principle agreed under BEPS Action 5 (Ireland, the Netherlands, the United Kingdom). Others (France, Italy) are maintaining regimes which seem incompatible. On the other hand, in January 2017,

58 The OECD has offered to help with translations.

59 Council Directive (EU) 2015/2376 of 8 December 2015 amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

60 Council Directive (EU) 2016/881 of 25 May 2016, amending Directive 2011/16/EU as regards mandatory automatic exchange of information in the field of taxation.

61 Council directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market.

Germany adopted counteracting measures, to disallow deductions to entities benefiting from such incompatible regimes.

Some of the changes will be adopted through international ‘soft law’, especially the amended Transfer Pricing Guidelines (Actions 8-10, which are Common Approaches, and Action 13, a minimum commitment). These were approved by the OECD Council in May 2016, so are regarded as a commitment for OECD members. Approval by the G20 of the BEPS outcomes implies the same for non-OECD G20 states. Preparation of a revised edition of the TPGs as a whole requires some further conforming changes, and a discussion draft was issued to Chapter IX on business restructuring for comments by August 2016. However, the revised edition of the TPGs as a whole is still awaited. The UNTC issued the 2nd edition of the UN Practical Manual on Transfer Pricing during its meeting of April 2017. This has incorporated the changes resulting from the BEPS reports, as well as continuing to include the additional chapter on the practices of emerging economies, updated and now including Mexico.

In a number of countries, the TPGs have quasi-legal status, notably in the United Kingdom⁶² and in Anglophone African countries.⁶³ Other countries prefer to enact their own domestic regulations, which may follow the TPGs, but with idiosyncratic variations. The United States seems unlikely to amend its regulations, which it considers are already broadly in line with the revised TPGs. China issued new draft regulations in Autumn 2015 for consultation; a year later the parts dealing with documentation were finalised, but the substantive regulations are still pending. Another open question is how other countries, which have not previously formally adopted the TPGs, will treat the new version.

The TPGs will now also include the provisions for country-by-country reporting and transfer pricing documentation, from the Action 13 report of October 2015, as Chapter V of the TPGs, together with four Annexes. They specify the templates for the three types of report, and outline the procedures for filing and dissemination. The Annex on dissemination provides model legislation that countries can use or adapt to the needs of their own legal systems. It also includes the Multilateral Competent Authority Agreement, and two model bilateral agreements, which can be used as a basis for exchange of the reports, together with a questionnaire relating to confidentiality and data safeguards, as well as appropriate use protection. In March 2016, the OECD released a standardised electronic format for the exchange of these reports, together with a User Guide. By 7 December 2016, 50 countries had joined the multilateral competent authority agreement, although not the United States⁶⁴ and a few developing countries. Additional documentation was issued in June 2016, and updated in December 2016, dealing with transitional filing options for MNEs, application of the requirement to investment funds and to partnerships, and interpretation of how to apply the EUR 750 million filing threshold due to currency fluctuations.

62 The United Kingdom formally incorporated the revisions to the TPGs made by the report on BEPS Action 8-10, as guides to interpretation of tax treaty provisions under section 164(4) of TIOPA 2010, by virtue of section 75 of the Finance Act 2016.

63 See, for example, Nigeria Income Tax (Transfer Pricing) Regulations 2012; Tanzania Income Tax (Transfer Pricing) Regulations 2014.

64 The United States issued a model Competent Authority Agreement for bilateral exchange of CbCRs in April 2017.

4.3 The continuing standard setting

A number of the Action Points remained incomplete, and since October 2015 the OECD has continued to release drafts for discussion. These are: treaty residence of pension funds, and treaty entitlement of non-collective-investment vehicle funds (Action 6); interest deductions in the banking and insurance sector, and aspects of the group ratio rule (Action 4); conforming changes to Chapter IX of the TPGs in business restructurings, and revised guidance on profit splits (Actions 8-10); branch mismatch structures (Action 2); and attribution of profits to permanent establishments (Action 7). Final reports on these are expected in 2017.

Although most of them are very technical, some do raise significant policy issues, especially in relation to the interaction between taxation and financial regulation. For example, allowing pension funds and non-collective-investment vehicles to be treated as resident in offshore financial centres and to obtain tax treaty benefits (low or no withholding taxes on their investment returns) is important for the future of offshore financial centres; but it also raises questions about whether such entities may facilitate money laundering or tax evasion. This could be dealt with, for instance, by linking tax treaty benefits with compliance with transparency requirements ('know-your-customer' requirements and automatic exchange of information), but this was not part of the proposal. The treatment of interest deductibility for financial and insurance firms interacts with capital adequacy regulatory requirements in those sectors. Since tax is dealt with in the G20 finance track, there may be an opportunity to check that these interactions have been adequately taken into account. However, generally such reports would not be discussed at G20 level unless an issue remains unresolved.

Among the immediate issues left over, the work on the 'profit split' method, and the attribution of profits to 'permanent establishments' are the most important. The difficulty of resolving these highlights the limitations of the achievements of the BEPS project, in failing to examine alternatives to the 'separate entity' principle and the 'arm's length standards'. The reasons are easy to understand: firstly, the origins of the project and the formulation of the BEPS Action Plan from within the community of international tax experts; secondly the need to work by consensus; and thirdly the urgency to produce results within a short timeframe in response to the political mandate. Given these factors, there was little chance that the project would take a fresh look at the problem or explore a new approach. Nevertheless, there is scope for strengthening the profit split method in ways which would open up such a perspective (Kadet, 2015).

The need for a new approach was most clearly identified by Action 1 on the Digital Economy. Not surprisingly, no agreement could be reached within the BEPS project timetable, so the deadline for this action was extended to 2020. However, this may not provide a period for calm reflection, since the space left by the absence of an agreed multilateral approach is quickly being filled by unilateral measures.

Notably, in June 2016 India introduced an Equalisation Levy, to apply in the first instance to payments for cross-border advertising services, at the rate of 6 per cent. This was introduced on a provisional basis, and is being revised. The United Kingdom's Diverted Profits Tax of 2015 – although in some respects broader in scope – also addresses the issue of companies selling into the country while avoiding a taxable presence. Australia has enacted similar legislation, and New Zealand has published draft legislation on similar lines.

Although both the DPT and the Equalisation Levy are designed to appear compatible with tax treaties, there is considerable uncertainty about this, although there has not yet been any formal legal challenge to either. Both are also intended to put pressure on MNEs to restructure their activities so as to pay more income tax in countries where they have significant sales, rather than be subject to these special levies. Pressure on MNEs has also been created by the renewed efforts by the European Commission’s Competition Directorate to apply the rules on state aids to open high-profile cases against well-known companies which have taken advantage of special rulings or favourable regimes in countries such as Ireland, Luxembourg and the Netherlands. A number of MNEs have announced a restructuring of their operations, which seems to be at least partly due to these pressures to align tax paid with economic activity. However, these seemed still to aim at minimising their tax liabilities based on deals or understandings with countries wishing to attract jobs.⁶⁵

At the same time, a number of international tax specialists have put forward proposals for a new approach to corporate taxation, a destination-based cash-flow tax (DBCFT) (see especially Auerbach, Devereux, Keen, & Vella, 2017; Devereux & de la Feria, 2014). This has now received considerable support in the United States, and a version was proposed in June 2016 by the Republican majority in the House Ways and Means Committee, which writes tax laws (US Congress, 2016). The brief outline for a US tax reform plan issued by the White House in late April 2017 suggested that the United States is intending to encourage repatriation of MNE profits held offshore through a reduced tax rate, and move to a territorial tax system with a 15 per cent corporate income tax rate, but did not include mention of the DBCFT.

The DBCFT, depending on its design, could be regarded as an export subsidy, and hence be challenged under world trade rules (Cui, 2017; Grubert, 2015), which would have very serious consequences. This would be ironic, since a major reason for the lack of progress in the TFDE was clearly the resistance of the US negotiators to accepting any move towards allocating tax base to countries where an MNE has sales without a related significant physical presence. A shift to this destination basis would allocate the entire tax base to the country of final sales: the June 2016 Republican proposal would tax firms selling in the US without allowing deduction of the costs of imports, while exporters would not be taxed and could deduct domestic production and investment costs (US Congress, Tax Reform Task Force, 2016). Taxation in the country of final sales is also the case for unitary taxation with formulary apportionment (UTFA) if apportionment is done solely based on sales. However, UTFA would allow deduction of worldwide costs, so would be unlikely to be regarded as an export subsidy.

Such unilateral measures can be designed in ways which mitigate or avoid conflicts. Thus, the DPT applies only to profits which would otherwise be lightly taxed. A principal target

65 Google announced a settlement of a six-year dispute with the United Kingdom in early 2016 which did not seem to involve acceptance that any tax is due in relation to its considerable sales in that country (Public Accounts Committee, 2016). Shortly afterwards it announced an expansion in the United Kingdom involving some one thousand additional jobs. In contrast, Facebook announced in March 2016 that it would begin routing sales to large UK advertisers through the United Kingdom, and in 2015 Amazon announced that it would start booking its European sales in the United Kingdom. Also, in December 2016, McDonalds announced that it would move several functions from its Luxembourg office to a new international holding company, based for tax purposes in the United Kingdom.

is the untaxed income of US-based MNEs accumulated offshore and benefiting from deferral of US taxation. If that income were to be repatriated and taxed in the future at a reasonable rate, as may occur as a result of US tax reform, the threat of the DPT would diminish or fall away. However, if the United States adopts a territorial system which exempts foreign income, as seems the more likely outcome, the DPT could continue to apply. Similarly, the European Commission's State Aid decisions also target only income which is taxed at a very low rate. The press release announcing its decision relating to the Irish subsidiaries of Apple, Inc., said that '[t]he amount of unpaid taxes to be recovered by the Irish authorities would also be reduced if the US authorities were to require Apple to pay larger amounts of money to their US parent company for this period to finance research and development efforts'.⁶⁶ Despite this, the US Treasury reacted very sharply, in particular writing to the President of the European Commission objecting to the State Aid decisions, and publishing a White Paper that read like a legal brief on behalf of the companies (US Department of the Treasury, 2016).

A key challenge now facing the G20 and the OECD is to find a way to defuse these escalating tax wars, and either ensure relatively compatible national measures, or make new efforts for a multilateral solution.

5 The future of global tax governance

5.1 The policy arena

As the evidence in the previous sections demonstrates, the OECD has become a global tax body in all but name. The infrastructure for this has been built since the 1990s, and especially with the creation of the FTA in 2002, and then the Global Forum. The partnership with the G20 since 2008 has cemented this position. From the perspective of the OECD, this now comprises four pillars (see OECD, 2016a, pp. 6-7):

- i) **Enhancing tax transparency:** centred on the Global Forum, especially its work on monitoring compliance with the standards for exchange of information on request; and since 2014 the common reporting standard for automatic exchange of financial account information.
- ii) **Addressing tax avoidance:** the BEPS Project and now its implementation.
- iii) **Tax policy:** the work on a range of tax policy issues, much of it under the umbrella of the Forum on Tax Administration; now badged as a partnership with the G20, as a result of the Tax Policy Symposium at Ministerial level held in Chengdu in July 2016, on the initiative of China and Germany, where the OECD made presentations on tax certainty and on tax and inclusive growth.
- iv) **Tax and development:** mandated by the G20 Development Working Group, to be done in conjunction with the IMF, United Nations and WBG in the Platform, reporting directly in the finance track.

⁶⁶ IP/16/2923 of 30 August 2016.

The OECD’s dominance in relation to the first two of these can fairly be said to be indisputable, resulting from the capacity it has shown to deliver practical and implementable technical solutions, at least until now. However, the OECD’s claims to dominance in technical capacity are less convincing in relation to the latter two, and indeed the Finance Ministers’ communiqué from Chengdu requested both the OECD and the IMF ‘to continue working on the issues of pro-growth tax policies and tax certainty’.

These institutional questions therefore also pose a key challenge for the G20. The OECD has made enormous efforts to remedy the legitimacy deficit due to its restricted membership and political identification as the ‘Club of rich countries’, first by admitting observers, then through the partnership with the G20, and finally creating a range of bodies open to all countries, particularly the FTA, the Global Forum and the Inclusive Framework. Yet the principle that all countries can participate truly ‘on an equal footing’ has yet to be realised in practice. Much of the activity of these ‘inclusive’ bodies consists of monitoring the compliance of all countries with standards developed by the OECD.

The partnership with the G20 has in some ways remedied this legitimacy deficit. First, it created political leverage against those OECD countries which obstructed some initiatives, and hence helped the efforts to ‘level the playing field’. Secondly, it involved at least the large developing/emerging economies in the G20 more directly in the formulation of the standards. Nevertheless, the perspective of capital-importing countries has not been adequately represented, and the voice of the OECD has largely drowned out those of the IMF, United Nations and WBG in the formulation of policy and measures on tax. The immediate need is to find more effective and constructive ways to harness and coordinate the respective strengths of these and other organisations.

In the longer term, it remains an open question whether a way can or should be found to move towards the creation of a global tax body. Pressures for this are continuing, now led by Ecuador, which took on the presidency of the G77 group at the United Nations in September 2016, strongly supported by civil society organisations (Eurodad, 2016). The previous attempt, at the UN Financing for Development conference in 2014 resulted in the Addis Tax Initiative, sponsored by the governments of Germany, the Netherlands, the United Kingdom and the United States, which now has over 45 country members. Its aims are to increase domestic revenue mobilisation for sustainable development, for which participating providers of international support pledged to collectively double their technical cooperation especially related to taxation by 2020, and to ensure policy coherence. It is facilitated by the International Tax Compact, an informal network formed in 2009, largely on the initiative of the German Ministry for Cooperation and Development (BMZ), and based in Bonn.

The Addis Tax Initiative was in effect a recognition of the need for improvement in many aspects of tax capacity building for developing countries. The doubling of assistance, even if it is achieved by the target date of 2020,⁶⁷ starts from a very low level: tax activities are estimated at amounting to only some 0.15 per cent of total development assistance (Platform for Collaboration on Tax, 2016, p. 6). Even more important is the commitment to improving

67 The OECD is monitoring the data, and has created a new code for tax-related aid in the OECD Overseas Development Assistance database; the initial data submitted for 2015 (the baseline for the Addis commitment) are now available, but subject to verification.

the coherence and effectiveness of the efforts, which was the focus of the report from the Platform to the G20 Finance Ministers in 2016. It found that around 25 bilateral donors are active in tax, and a mapping by the Compact showed that as many as five have been active in the same country at the same time, while other countries receive no support; an IMF stocktaking counted 50 providers active in sub-Saharan Africa alone, an average of 5-6 per country, and a total of 208 programmes (Platform for Collaboration on Tax, 2016, p. 12). Coordination still seems far off, as even information flows ‘remain to a large degree matters of happenstance and personal contacts’, so there is ‘clear scope for improvement’ (Platform for Collaboration on Tax, 2016, p. 28).

The Platform’s report also pointed out that ensuring that developing countries can benefit from the reform of international tax rules requires that rules are formulated which reflect the circumstances and priorities of those countries. However, there remains a considerable gap between the capacity building efforts, and the bias of the institutional structures which do not facilitate the active engagement of developing countries with formulating policy and regulatory reforms. The resistance of the OECD countries even to an upgrading of the UNTC, and their failure to support an increase in its resources also cast doubts on the sincerity of their statements that reform of the rules should take account of the needs and interests of developing countries. At the same time, developing country officials participating in OECD working parties have been deterred from expressing concerns about the unsuitability of existing rules and approaches, by both peer pressure and high-level political contacts between senior OECD officials and national leaders.

Capacity building therefore runs the risk of wasting large resources in attempting to improve the enforcement of rules which are complex, hard to administer, and ineffective for developing countries. The bulk of this activity consists of sending advisers from OECD countries to train developing country tax officials to apply rules and methodologies which in the OECD countries themselves have proved problematic and ineffective. Although the Addis Initiative refers to supporting South-South cooperation, in practice it is rare.⁶⁸ A recent comprehensive Handbook on Transfer Pricing and Developing Economies published by the World Bank (Cooper et al., 2016) provides a clear and exhaustive explanation and presentation of the complex techniques and methods based on the OECD approach. Yet, in nearly 400 pages, there were only scattered mentions of Brazil’s approach and experience, although it seems to have provided a simple and easily administered system for transfer pricing which could be better suited to developing countries.

As regards international business taxation in particular, the formulation of rules has been dominated by the perspective of capital-exporting countries, which the UNTC has done little to redress due to its weakness. The OECD has also so far provided only patch-up remedies, due to the need to reach consensus among a large number of countries, including some which sought to protect their economies through ‘beggar-thy-neighbour’ tax policies. The involvement of the G7/8, and then the G20, has only partly remedied the problem. It remains to be seen whether the widening out to the Inclusive Framework will provide the policy space to produce more comprehensive reforms and truly global solutions.

68 Tax Inspectors without Borders recently proudly announced a cooperation agreement between Kenya and Botswana; however, this was evidently facilitated by the recruitment in 2016 as head of Tax Inspectors without Borders of James Karanja, who had been head of international tax at the Kenya Revenue Authority (KRA), a sore loss for the KRA.

5.2 The actors and their roles

5.2.1 Governments

An important role will be played in 2017 by **Germany**, which holds both the G20 presidency and the chair of the OECD CFA, and which also seems to have been a driving force behind the 2012 start of the BEPS project. However, instead of now focussing on the BEPS project and its implementation, or the source-residence issue, Germany has brought the issue of ‘tax certainty’ into the G20 agenda, and also seems to be following up the issue of tax policies for ‘inclusive growth’ brought in by China.⁶⁹ Germany has been playing a leading role in prioritising tax in the context of domestic resource mobilisation for development, mainly in terms of capacity building. This could perhaps be extended into facilitating stronger contributions from developing and capital-importing countries into policy formulation. This could be especially effective if it can take forward its coordination with the past presidency of **China** into the next one of Argentina. China has not yet finalised the transfer pricing rules it proposed over a year ago which suggested a possible new approach based on value chain analysis. The contribution of **Argentina** in relation to tax has been to some extent hampered by the political difficulties of its previous administration under Cristina Kirchner, and then the transition to President Macri. **India** is revising its equalisation levy, which may be given wider scope but at a lower rate. **Brazil** may consider revisions to its fixed margin method to bring it more into line with the OECD arm’s length principle.

A key part of the jigsaw is the **United States**, which needs both to align with the CRS and carry out a corporate tax reform that removes the need for countermeasures such as the DPT, without adopting rules that would constitute an enormous trade subsidy. The transition to the Trump administration, with a closer alignment to Republicans in Congress, perhaps provides the opportunity for this, but also creates unpredictability and uncertainty. Since the White House has now proposed a shift to a territorial tax system that will likely have insufficient base erosion protections, and this would be supported by the Republicans (who control the Congress), there is real risk that the US tax reform (with or without the destination-based sales approach) will continue to permit MNE structures that maximise overseas zero and low-taxed income. If this occurs, other countries will continue to feel the need for counteracting measures such as the DPT to impose tax on many US MNEs. In addition, the Republicans have not reacted favourably to some of the BEPS measures that they see as unfairly targeting US MNEs, or to the tax transparency initiatives. Thus, there is considerable doubt over the involvement of the United States in the various arrangements which require mutual cooperation.

The position of the **United Kingdom**, hitherto a strong supporter of all the OECD initiatives (while quietly introducing and defending tax incentives such as the patent box, and continuing to lower its tax rate), may also create some uncertainty now due to Brexit, which has resulted in suggestions that it could further cut its corporate tax rate even below the anticipated 17 per cent in 2020, and this may be accelerated by the announced intention of the US administration to reduce the US corporate tax rate to 15 per cent.

69 As mentioned above, these have been already picked up by the OECD, which is pursuing the issue of tax certainty with a survey of business concerns.

Although the **European Union** made a quick start in introducing the transparency measures and the first anti-tax-avoidance directive (ATAD), the latter adopted low standards. Governments rejected measures that initially were proposed to go beyond the BEPS accord, such as a general ‘switch-over’ clause, and the directive to end the use of hybrid mismatch structures with third countries is being delayed by the demands of the **Netherlands** for a long transition period. The bold actions of the Competition Directorate in applying the State Aid rules have put pressure on Belgium, Ireland, Luxembourg and the Netherlands, although the decisions may not be upheld by the Court. Progress is needed on the Common Consolidated Tax Base, which would resolve at least many of the intra-EU problems, which will require strong leadership from Germany supported by France, Italy and Spain, all of which however have significant fiscal problems. In general, however, the European Union has been in the forefront in introducing transparency measures, due to strong civil society pressures.

Countries around the world which have benefited from acting as conduits or havens are facing continuing pressure from the tightening of standards of transparency, and now also the BEPS measures. Most have chosen to adapt, although as slowly as possible, while searching for economic alternatives; examples are Mauritius, the UK dependencies, Andorra, Liechtenstein and Switzerland. Others, such as Panama, have shown greater reluctance, and may become more difficult to persuade if the United States under President Trump fails to improve on FATCA or even relaxes it. Such jurisdictions are likely to resort to new types of tax incentives, leading to what has been described as ‘corporate tax havens’ (Oxfam, 2016). This will need to be evaluated by the Forum on Harmful Tax Practices, and may result in countermeasures by some OECD states. Even as many improve, it may become more difficult to monitor the more low-profile and laggard countries, such as the United Arab Emirates, or Liberia. Sub-state jurisdictions such as Aruba-Curaçao-Sint Maarten, and Puerto Rico will also pose special problems.

5.2.2 Civil society

Campaigners for ‘tax justice’ have been a major force, especially since the financial crisis. They are now quite well coordinated regionally (especially in Africa, Europe and Latin America) and under the overall umbrella of the Global Alliance for Tax Justice. Particularly effective have been their research-based campaigning material, often targeting high-profile companies, underpinned by longer-term work such as the Financial Secrecy Index, and the work of the Financial Transparency Coalition, and Global Financial Integrity. Although traditional trade unions have not been active on tax issues, some have become alerted to the issue, and the public service unions in particular have joined the campaigners. Tax academics, think-tanks and research centres have helped inform the debate, although few have made direct contributions to the OECD consultations, perhaps because of the short deadlines. The gap has been to some extent filled by the BEPS Monitoring Group, an international network of independent researchers and academics, which submitted comments on virtually all the discussion drafts, and participated actively in the public consultations.

Investigative journalism has also made a significant impact, through both well-informed individuals and teams. The formation of wider consortia, especially the International Consortium of Investigative Journalists, has enabled the analysis and skilful use of large-

scale data leaks, notably the LuxLeaks and the Panama Papers. News stories have been timed just in advance of key meetings of the G20 and other bodies, and have had undeniable effects. The specialist international tax media have done a good job tracking and commenting on the initiatives, especially Tax Analysts and Bloomberg, although most of their output is behind high paywalls. There remains a wide gap between this specialist commentary and coverage of the issues even in the well-informed quality media outlets.

5.2.3 Business and professionals

International tax professionals have been very active throughout, especially by engaging with the consultations and other lobbying efforts, through a variety of bodies. Divergences in perspectives emerged, with some taking strongly defensive or even hostile attitudes, while others accepted that change was needed while cautioning against radicalism. The main business grouping at the OECD, its Business and Industry Advisory Committee (BIAC), has been ably and diplomatically led by Will Morris (Director of Global Tax Policy of GE International, in the United Kingdom). In April 2017 he moved, together with GE’s 600-strong global tax team, to PwC.

Enormous resources have been applied to dissecting and criticising the OECD’s discussion drafts by a wide variety of bodies, including professional firms such as the Big Four and large law practices, boutique international tax firms, umbrella business associations (BDI, CBI, Keidanren), sectoral associations (Silicon Valley Tax Directors) and networks of tax professionals. They have also had the advantage of including in their ranks many who have previously worked in the OECD and government, although this has also been a disadvantage in the context of the OECD’s changed direction under new leadership and stronger political pressures.

5.2.4 Inter-governmental organisations

The OECD has been ably and astutely led by Pascal St-Amans, backed by an intelligent and active team of senior staff, and a flow of newer recruits. Its strength, as the preceding account evidences, has been its ability to deliver practical and implementable policy measures and proposals, which could be agreed by consensus. Much is due to its structure, which gives a directing role to high-level government tax policy makers (in the CFA and especially its Bureau), while its skilled staff can produce high quality technical papers which are also attuned to policy constraints. It has also succeeded in building a large outreach organised under its Global Relations Programme, as well as Tax Inspectors without Borders. These activities – more than the policy work – have taken it deep into the territory of other intergovernmental organisations, especially the IMF and the WBG, the strength of which has been country advice and capacity building. Attempts to improve coordination between the organisations, through the International Tax Dialogue, had limited success, and it remains to be seen whether its successor, the Platform for International Collaboration on Tax can improve on this. One test will be the quality of the Toolkits for developing countries which have been requested by the G20.

6 Conclusions

It is clear that international corporate taxation remains seriously dysfunctional. The unprecedented multilateral efforts to reform it through the BEPS project achieved some significant repairs, but not the more radical overhaul many considered is needed. Work is continuing on issues which it did not resolve, centring on the key issues of allocation of profit, especially in the context of digitalisation of business models. In the meantime, many states are adopting unilateral measures to protect their tax base while aiming to attract investment, amounting virtually to an international tax war.

Political leaders, responding to a strong wave of public opinion ably articulated by tax justice campaigners, have provided needed political support for the efforts of technical specialists to find effective solutions. However, they should not relax now into thinking that the problems have been solved. On the contrary, a renewed effort is now needed, to stave off the growing threats of mutually damaging unilateral actions. The need for decision by consensus creates a prisoners' dilemma, in which all will lose unless there is a realisation of the need for stronger collective action. This is not a matter of idealism, but of political realism. All those involved in this issue must play their part, but a particular responsibility lies on political and corporate leaders to provide a new impetus for a better approach.

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Annex

Tax Annex to the Saint Petersburg G20 Leaders Declaration

1. **The G20 has been at the forefront of efforts to establish a more effective, efficient and fair international tax system since they declared the era of bank secrecy over at the G20 London Summit in April 2009.** In an increasingly borderless world, strengthening international cooperation in tax matters is essential to ensuring the integrity of national tax systems and maintaining trust in governments.
2. **The Global Forum on Transparency and Exchange of Information for Tax Purposes has played a critical role in ensuring that the international standard of exchange of information on request endorsed by the G20 is implemented effectively around the world.** Since the Global Forum responded in 2009 to the G20’s call to ensure rapid implementation of its standards of transparency and exchange of information, the Global Forum has completed 113 peer review reports and has issued over 600 recommendations for improvement, with more than 300 of those recommendations having been acted upon to date. The number of jurisdictions that have committed to implement the standards and have joined the Global Forum has increased to 120. All but 14 of the jurisdictions reviewed have advanced to Phase 2 reviews, thus demonstrating the effectiveness of the peer review process in achieving the implementation of the standards. Those 14 jurisdictions are urged to implement the Global Forum’s recommendations without further delay. In July 2013, G20 Finance Ministers and Central Bank Governors asked the Global Forum to give overall ratings of exchange of information on request at its meeting in November 2013. The Global forum will draw on the work of FATF on beneficial ownership and ensure that all countries have information regarding the beneficial ownership of entities operating in their jurisdictions.
3. **The G20 has now endorsed the development of a new global tax standard: to automatic exchange of information.** At the Cannes Summit in 2011, the G20 agreed to consider exchanging information automatically for tax purposes on a voluntary basis. In 2012, the Los Cabos Summit welcomed the OECD report on automatic exchange and encouraged all countries to join this practice. Given the developments in the Global Forum and other recent advances, it is now time to migrate to a more ambitious, more efficient and higher standard, which is automatic exchange of information. Recent developments involving undisclosed foreign bank accounts have also highlighted the urgent need to move to this new standard which the Global Forum will monitor to ensure its effective implementation. In July 2013, G20 Finance Ministers and Central Bank Governors fully endorsed the ambitious OECD proposal for a truly global model for multilateral and bilateral automatic exchange of information for tax purposes and declared their commitment to automatic exchange of information as the new global standard. The OECD has initiated work with G20 countries to develop the new single global standard for automatic exchange of information. G20 Finance Ministers and Central Bank Governors have mandated the OECD to provide a progress report at the October Finance Ministers’ meeting, including a timeline for completing this work in 2014. The new standard (included in a Model Competent Authority Agreement) will be presented at G20 Finance Ministers and Central Bank Governors’ meeting in February 2014. There is a clear need for the practical and full implementation of this new tax standard on a global scale. The Global Forum will establish a mechanism to monitor and review the implementation of the new standard on automatic exchange of information and will be working with the OECD Task Force on Tax and Development, the World

Bank Group and others to help developing countries identify their need for technical assistance and capacity building.

4. **The next challenge regarding automatic exchange of information is now to get all jurisdictions to commit to this standard and put it into practice.** Calling on all other jurisdictions to join us by the earliest possible date, we are committed to automatic exchange of information as the new global standard, which must ensure confidentiality and the proper use of information exchanged, and we fully support the OECD work with G20 countries aimed at presenting such a new single global standard for automatic exchange of information by February 2014 and to finalizing technical modalities of effective automatic exchange by mid-2014. In parallel, we expect to begin to exchange information automatically on tax matters among G20 members by the end of 2015. **The multilateral Convention** is key to ensuring rapid implementation of the new standard and to enabling developing countries to benefit from the new more transparent environment. In 2009 the OECD and the Council of Europe swiftly responded to the G20's call for a multilateral instrument by amending the Convention on Mutual Administrative Assistance in Tax Matters in 2010 to meet international standards and to allow all countries with domestic laws that are sufficient to uphold the confidentiality of tax information to join. All G20 countries have led by example in signing this Convention and to date more than 70 countries and jurisdictions are covered or are likely to be covered by the Convention, including significant financial centres. The Convention is a powerful tool in the fight against tax evasion and allows for all forms of cooperation in tax matters, including automatic exchange of information. We expect all jurisdictions to join the Convention without further delay.
5. **International collective efforts must also address the tax base erosion resulting from international tax planning.** Base erosion and profit shifting (BEPS) relates chiefly to instances where the interaction of different tax rules result in tax planning that may be used by multinational enterprises (MNEs) to artificially shift profits out of the countries where they are earned, resulting in very low taxes or even double non-taxation. These practices, if left unchecked, undermine the fairness and integrity of our tax systems. They fundamentally distort competition, because businesses that engage in cross-border BEPS strategies gain a competitive advantage compared with enterprises that operate mostly at the domestic level. Fair, transparent and efficient tax systems are not only key pillars for sound public finances, they also provide a sustainable framework for dynamic economies. For these reasons, G20 Leaders identified the need to address BEPS as a priority in their tax agenda at the Los Cabos Summit in June 2012. Additionally, we must achieve better international coordination on taxes. In this regard, we must move forward in fighting BEPS practices so that we ensure a fair contribution of all productive sectors to the financing of public spending in our countries.
6. **International tax rules, which date back to the 1920's, have not kept pace with the changing business environment, including the growing importance of intangibles and the digital economy.** In response to a G20 mandate, the OECD Secretary-General provided a report in February 2013 outlining the issues related to BEPS, and has now presented an ambitious and comprehensive Action Plan developed with G20 members aimed at addressing BEPS, with a mechanism to enrich the Plan as appropriate. Countries will need to examine how their domestic tax laws contribute to BEPS and to ensure that international and domestic tax rules do not allow or encourage multinational enterprises

to reduce overall taxes paid by artificially shifting profits to low-tax jurisdictions. A G20/OECD BEPS Project has been established through which all non OECD G20 countries will participate on an equal footing to develop proposals and recommendations to tackle the 15 issues identified in the Action Plan. G20 Leaders commit themselves to a swift implementation and they also have a vital role to play in urging other countries to join with us and to take the necessary individual and collective actions to implement these proposals and recommendations in a timely manner. G20 Leaders appreciate the swift and effective response by the OECD in advancing the BEPS agenda and urge the OECD to work closely with G20 countries for the proper implementation of this Project.

7. The Action Plan aimed at addressing BEPS sets forth an ambitious agenda to examine the following fundamental aspects of the international tax rules:

- **First, changes to international tax rules must be designed to address the gaps between different countries’ tax systems, while still respecting the sovereignty of each country to design its own rules.** Instruments will be developed to neutralise hybrid mismatches and arbitrage; recommendations will be developed regarding best practices in the design of domestic legislation to protect the tax base of countries against shifting of profits to no or low taxation jurisdiction (through strengthening or introducing so called “CFC” rules – Controlled Foreign Companies); and recommendations will be developed regarding rules to prevent base erosion through interest deduction.
- **Second, the existing international tax rules on tax treaties, permanent establishment, and transfer pricing will be examined to ensure that profits are taxed where economic activities occur and value is created.** The action plan is designed to establish anti-treaty shopping provisions and develop changes to the definition of the permanent establishment (that is, whether there is sufficient nexus to allow a charge to tax) to prevent BEPS. Three actions are identified in the area of transfer pricing to put an end to the divorce between the location of profits and the location of real activities. Importantly, there is recognition that although the existing transfer pricing rules appropriately allocate income in many instances, special measures, either within or beyond the arm’s length principle, may be required to address certain specific difficulties arising in the current system.
- **Third, more transparency will be established, including through a common template for companies to report to tax administrations on their worldwide allocation of profits and tax.** It also requires more transparency between governments, with the need for countries to disclose rulings and other tax benefits to their partners, and disclosure by taxpayers of aggressive tax planning arrangements. The Action Plan also provides mechanisms to collect better data so as to be able to measure BEPS and carry out the relevant economic analyses.
- **Fourth, all the actions are expected to be delivered in the coming 18 to 24 months.** To ensure that the recommendations may be implemented quickly, the OECD will be developing a multilateral instrument for interested countries to amend their existing network of bilateral treaties.

8. Developing countries must reap the benefits of the G20 tax agenda. The G20-led efforts can advance efforts to improve domestic resource mobilisation. The Global

Forum on Transparency and Exchange of Information, the OECD Task Force on Tax and Development, the World Bank Group and other international organizations are key partners who can assist developing countries identify their needs for technical assistance and capacity building in implementing of the transparency and exchange of information standards, including through the multilateral Convention and automatic exchange of information. These efforts will help developing countries secure the corporate tax revenue they need to foster long-term development. The OECD's Tax Inspectors Without Borders initiative to assist tax administrations of developing countries plays a useful role in this regard. Finally, we are committed to continue to assist developing countries, including through the IOs, in identifying individual country needs and building capacity in the area of tax administration (in addition to automatic exchange of information) and encourage such support to be developing country led.

9. **International taxation issues do not stop at addressing double non-taxation.** We encourage continued discussion on other tax matters among tax administrators.

Annex – The 15 actions to address BEPS

ACTION 1 – Address the tax challenges of the digital economy

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

ACTION 2 – Neutralise the effects of hybrid mismatch arrangements

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.

ACTION 3 – Strengthen CFC rules

Develop recommendations regarding the design of controlled foreign corporation rules. This work will be co-ordinated with other work as necessary.

ACTION 4 – Limit base erosion via interest deductions and other financial payments

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.

ACTION 5 – Counter harmful tax practices more effectively, taking into account transparency and substance

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.

ACTION 6 – Prevent treaty abuse

Develop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances. Work will also be done to clarify that tax treaties are not intended to be used to generate double non-taxation and to identify the tax policy considerations that, in general, countries should consider before deciding to enter into a tax treaty with another country. The work will be co-ordinated with the work on hybrids.

ACTION 7 – Prevent the artificial avoidance of PE status

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.

ACTION 8, 9, 10 – Assure that transfer pricing outcomes are in line with value creation

Action 8 – Intangibles. Develop rules to prevent BEPS by moving intangibles among group members. This will involve: (i) adopting a broad and clearly delineated definition of intangibles; (ii) ensuring that profits associated with the transfer and use of intangibles are appropriately allocated in accordance with (rather than divorced from) value creation; (iii) developing transfer pricing rules or special measures for transfers of hard-to-value intangibles; and (iv) updating the guidance on cost contribution arrangements.

Action 9 – Risks and capital. Develop rules to prevent BEPS by transferring risks among, or allocating excessive capital to, group members. This will involve adopting transfer pricing rules or special measures to ensure that inappropriate returns will not accrue to an entity solely because it has contractually assumed risks or has provided capital. The rules to be developed will also require alignment of returns with value creation. This work will be co-ordinated with the work on interest expense deductions and other financial payments.

Action 10 – Other high-risk transactions. Develop rules to prevent BEPS by engaging in transactions which would not, or would only very rarely, occur between third parties. This

will involve adopting transfer pricing rules or special measures to: (i) clarify the circumstances in which transactions can be recharacterised; (ii) clarify the application of transfer pricing methods, in particular profit splits, in the context of global value chains; and (iii) provide protection against common types of base eroding payments, such as management fees and head office expenses.

ACTION 11 – Establish methodologies to collect and analyse data on BEPS and the actions to address it

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.

ACTION 12 – Require taxpayers to disclose their aggressive tax planning arrangements

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.

ACTION 13 – Re-examine transfer pricing documentation

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

ACTION 14 – Make dispute resolution mechanisms more effective

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

ACTION 15: Develop a multilateral instrument

Analyse the tax and public international law issues related to the development of a multilateral instrument to enable jurisdictions that wish to do so to implement measures developed in the course of the work on BEPS and amend bilateral tax treaties. On the basis of this analysis, interested Parties will develop a multilateral instrument designed to provide an innovative approach to international tax matters, reflecting the rapidly evolving nature of the global economy and the need to adapt quickly to this evolution.

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