Editor:
Joanna Wheeler

Single Taxation?

IBFD

Single Taxation?

Why this book?
Single taxation has instinctive appeal as a policy goal, but a close examination of this seemingly simple slogan reveals a complex set of issues that do not lead to clear or simple answers. In October 2017, IBFD held a one-day symposium, exploring the notion of single taxation, to celebrate the third year of the Advanced Master's in International Tax Law Programme offered by IBFD and the University of Amsterdam as a cooperative venture.

This book contains the papers written in connection with this symposium. It starts with the LLM thesis of one of the graduates of the 2016/17 Advanced Master's Programme, which carries out an in-depth investigation of what single taxation might mean in one common business structure. The remaining contributions follow the format of the symposium, each aspect of the topic being addressed in two papers that were written by leading authors independently of each other. The final two chapters reflect the Oxford-style debate that provided a lively finale to the symposium day.

In offering two views of each segment of the issue, this book is intended to provoke discussion. In particular, it is hoped that it will encourage students of international tax law, of all ages and at all stages of their careers, to question their assumptions and form their own opinions.

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Foreword

IBFD is proud to present this book as the product of a symposium held in October 2017 to celebrate the third year of the advanced LL.M. programme, "International Tax Law: Principles, Policy and Practice", offered jointly by the University of Amsterdam and IBFD. This symposium is an annual event held at the IBFD premises with many leading speakers, a limited number of participants and a programme designed to encourage debate. Much of the programme takes the form of "duets", in which two speakers engage with each other about one segment of the symposium topic. In 2017, the programme for the first time concluded with an Oxford-style debate between two academics, each supported by a graduate of the 2016/17 LL.M. programme, which provided a lively close to the day.

This book starts with an adapted version of the LL.M. thesis written by one of the graduates of the 2016/17 programme, which explores the notion of single taxation and raises many questions. It continues with two contributions for each of the segments addressed during the symposium. In providing two discussions of the same issue, with different approaches, the aim of the book is to explore the richness of international tax law in order to provide inspiration to future generations of students and encourage them to develop their own approach to the discipline.

IBFD wishes to express its gratitude to all the speakers/authors for their contributions to the symposium and their written contributions to this book. We look forward to future editions of both and hope that we can continue to provide inspiration to students of international tax law, whether they are studying for their master's degree or are further advanced in their career but still interested in the fundamental issues.

Joanna Wheeler
Programme Director, Advanced LL.M., "International Tax Law: Principles, Policy and Practice"

Sample Content

Chapter 1

In Search of Single Taxation

Francesco De Lillo[1]

1.1. Introduction

Traditionally, the efforts of international cooperation in the field of taxation have primarily targeted double taxation issues. With regard to cross-border income, conflicting taxing claims overlap potentially leading to the imposition of an excessive tax burden that might hinder international trade and investments. Tax treaties represents the product of such an effort, as they are explicitly aimed at removing the "obstacles to the development of economic relations between countries"[2] deriving from international juridical double taxation.

In the past decades, the concerns of the international framework have increasingly shifted towards the opposite problem, which arises when cross-border income is unduly subject to a reduced level of taxation or somehow remains completely untaxed. It has been recognized that multinational enterprises diffusely engage in tax planning so as to achieve double non-taxation, and this phenomenon has become too significant to be further tolerated by the international community. The BEPS initiative promoted by the OECD and G20 ultimately constitutes the acknowledgement of such an emergency.

In this context, single taxation appears to be the policy goal envisioned by scholars and embodied by the relevant international organizations to address the harmful implications of both double taxation and double non-taxation.

As suggested by the terminology itself, the concept of single taxation implies that income is taxed once and only once. From a global policy

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1. This chapter is an adapted version of F. De Lillo, *In Search of Single Taxation: The Twilight of an Idol?*, LL.M Thesis, University of Amsterdam (2017). The author is deeply grateful to Joanna Wheeler for her patient supervision and the essential scientific (and moral) guidance: the paper is indeed the product of many afternoons spent together discussing the topic. Special thanks go also to Professor Reuven Avi-Yonah for his co-supervision and to Professors Daniel Berman, Frans Vanistendael and Luís Schoueri for their precious feedback.
2. OECD, *Model Tax Convention on Income and on Capital*, Introduction, para. 1 (OECD 2017), Models IBFD.

perspective, the imposition of a single layer of taxation would thus constitute the ideal and rightful tax treatment of cross-border income. It would hence seem consequential to recognize an underlying jurisdictional issue and to question *where* the single levy should be imposed and on the basis of which policy considerations. Prima facie, the single tax principle could be regarded as an allocation rule conceived to divide the concurrent taxing claims of the residence and the source jurisdictions on cross-border income.

Nevertheless, while pursuing the ideal of single taxation, the international debate tends to be reluctant to explicitly address such a jurisdictional issue. Yet, if the main concern does not involve the identification of the jurisdiction entitled to impose the single levy, what would be the rationale of the single tax principle? In the light of which considerations would one layer of fiscal imposition be more rightful than two or none?

Taking into account the above observation, substantial doubts arise. It seems difficult to justify, from a theoretical perspective, the relevance of the number of levies per se imposed on cross-border income and to further argue that states should unilaterally comply with such a policy, designing their own systems on the basis of the features of the other jurisdictions. More likely, the problem that should be solved or fixed by single taxation is different: after reading the arguments in support of the existence of the single tax principle, the impression is that the real concern to be addressed can be regarded as an "amount issue" that involves the overall tax burden imposed on cross-border income.

Thus, the chapter intends to analyse the theoretical configuration of the single tax principle and to assess how it has been envisioned by the OECD and promoted within the BEPS Project. The research will highlight several inconsistencies, which indicate that, at the current stage, it is still difficult to ascribe precise and coherent content to such a concept or to identify the underlying policy justifications. Section 1.2. examines the theoretical formulation of the principle by mainly focusing on Avi-Yonah's theories. Section 1.3. analyses the so-called situation of "less than single taxation", illustrating how double non-taxation occurs, why it is "evil" and for which reasons it should be addressed in compliance with the single tax principle. At the same time, the methodological approach that will be used in the overall research is introduced. A concrete hybrid mismatch arrangement, the Dutch CV-BV structure, will serve as a test to provide a better understanding of the theoretical background underlying the single taxation ideal. Section 1.4. assesses the achievement of single taxation as proposed by the OECD with regard to reverse hybrid mismatches, pointing out several

weaknesses of this solution. Lastly, section 1.5. takes into consideration some alternatives to neutralize the concrete mismatch, thus preparing the ground for drawing the overall conclusions.

1.2. The single tax principle: Historical background

1.2.1. Preliminary remarks

Reflecting on the taxation of cross-border income from an international policy perspective, two fundamental dilemmas must be addressed:

- How should the income derived from international transactions be taxed, or, in other words, "what is the appropriate level of taxation that should be levied"[3] upon it?

- Where should such income be taxed and how should the revenues be divided between the involved jurisdictions?

According to a controversial thesis formulated by some scholars (especially by Avi-Yonah), which has gained, over time, an increasingly wide consensus, the answer to these questions is provided by two interrelated concepts, i.e. the single taxprinciple and the benefits principle. In this context, these principles constitute the core of an allegedly inherent "international tax regime". Yet, by reading the arguments of the single tax principle's supporters, some questions arise intuitively: What does single taxation exactly mean? Are we dealing with a jurisdictional issue, hence related to the "number" of levies, or with an amount issue concerning the rates of taxation?

1.2.2. The single tax principle

1.2.2.1. Notion

The single tax principle can be formulated as follows: "Income from cross-border transactions should be subject to tax *once* (that is, *neither more nor less* than once)."[4] (Emphasis added)

3. R.S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 Tax Law Review 3, p. 517 (1997). The two basic issues are further expressed as "defining the tax base" and "dividing the tax base".
4. Id. This formulation constitutes the starting point of a coherent structure further developed by Avi-Yonah, and it has been recalled in several papers. *See*, for example,

By addressing the definition of the tax base in respect of income arising in one country and paid to a resident of another jurisdiction,[5] the principle appears to entail per se the imposition of a single layer of taxation at the rates established by the benefits principle, which allocates the primary right to tax active income to the source jurisdiction while leaving to the residence state the primary tax claims over passive income. In the light of these indissociable rules, the concerns underlying the taxation of cross-border income can be regarded prima facie as a jurisdictional matter: the recognition of a sort of "natural" right to be subject to tax on every item of income only once unavoidably leads to the issue of where this single tax should be levied. The allocation rule incorporated in the benefits principle can be properly justified, both on a theoretical and a factual level.[6]

With regard to passive income, residence-based taxation seems to be the most reasonable and feasible solution, as investment income is mainly earned by individuals. In such case, residence can be easily established and the distributive function of taxation can be addressed more efficiently, as the resident individual can take advantage of all the social benefits provided by the jurisdiction in which he is established. On the other hand, business income is primarily derived by corporations, the residence of which is an extremely volatile concept, especially in the era of globalization and digital communications (both of the traditional criteria based on the place of incorporation (POI) or the place of effective management (POEM) can be easily manipulated by taxpayers). Since multinational enterprises are not part of a single society and their income cannot be attributed to any specific jurisdiction for distributive purposes, source-based taxation turns out to be more consistent from a benefits perspective; after all, businesses benefit from infrastructure, labour and other resources of the country in which they

R.S. Avi-Yonah, *International Tax Law as International Law*, 57 Tax Law Review 4 (2004); R.S. Avi-Yonah, *Tax Competition, Tax Arbitrage and the International Tax Regime*, 61 Bull. Intl. Taxn. 4, p. 131 (2007), Journals IBFD; R.S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of U.S. Treaty Policy*, 59 New York Law School Law Review, p. 306 (2014/15); and R.S. Avi-Yonah, *Full circle? The Single Tax Principle, BEPS, and the New US Model*, Global Taxation 1, pp. 12-13 (2016).

5. In this regard, *see also* J.M. de Melo Rigoni, *The International Tax Regime in the Twenty-First Century: The Emergence of a Third Stage*, 45 Intertax 3, p. 208 (2017).

6. For the sake of completeness, it is relevant to specify that Avi-Yonah recently proposed a re-evaluation of the benefits principle in light of the reality of globalization so as to tackle more effectively corporate tax avoidance and double non-taxation phenomena. In particular, passive income should be taxed primarily by the source state, while active income primarily by the residence state (*see* R.S. Avi-Yonah & H. Xu, *Evaluating BEPS: A Reconsideration of the Benefits Principle and Proposal for UN Oversight*, 6 Harvard Business Law Review 2, pp. 234-235 (2016-2017).

operate. Lastly, from a practical point of view, the source jurisdiction has, by definition, the first chance to tax income generated within its territory.[7]

Up until this point, one might be tempted to operate a logical "inversion" and consider the single tax principle as a corollary of the benefits principle. In other words, one might assert that cross-border income should be subject to a single layer of taxation due to the fact that overlapping taxing claims can be correctly divided on the basis of the above theoretical and pragmatic grounds.

Yet, several elements lead to a different conclusion that clashes with the idea of reducing the single tax theory to a mere jurisdictional issue. First, further arguments proposed by the major supporter of the thesis at stake, Avi-Yonah, assess the compatibility of the benefits principle with the single taxation principle by focusing on rates. After comparing the variability of the top marginal individual income tax rates and corporate tax rates among OECD member countries, Avi-Yonah concludes that "all income from cross-border transactions under current rate structures should be taxed at a rate between approximately 30% (the lower end of the source rates) and 60% (the higher end of the residence rates)".[8] As confirmed by the further considerations below, the impression is that the concerns underlying the single tax principle consist in the achievement of a "fair" rate of taxation more than a proper allocation of taxing rights. Second, with regard to corporate income of multinational enterprises, the above principles are unable to clearly address the issue of dividing the tax base among the different jurisdictions providing benefits.[9] Last but not least, the single taxation principle allegedly includes a "residual" provision, by virtue of which the other jurisdiction should tax cross-border income if the state that has the primary taxing right under the benefits principle refrains from taxation[10] so as to avoid undertaxation.[11]

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7. For all of these arguments, *see* Avi-Yonah, *supra* n. 3, at pp. 520-521.
8. Id., at p. 522. The proposed range of rates was updated in a later study (the lower end of the source rates would be 25%, while the higher end of the residence rates would be 55%), but still, the distinction between active/corporate income and passive/individual income is compliant with the single taxation principle "since most of the rate divergence among taxing jurisdictions arises in the individual income tax, while corporate tax rates have tended to converge" (*see* Avi-Yonah 2007, *supra* n. 4, at p. 135).
9. Avi-Yonah, *supra* n. 3, at p. 517.
10. Id.
11. As further illustrated (*see* sec. 1.2.4.), double non-taxation is one of the "evils" that single taxation should prevent.

If we consider especially the last statement, it becomes clear that the single tax principle is described as a concept that goes beyond allocation rules or the perspective of a single jurisdiction. It can be regarded as a sort of superior and intrinsic principle that has two faces: on one hand, the "right" – attached to every item of income arising from cross-border transactions – to be subject to taxation no more than once, and on the other hand, the "obligation" of being subject to taxation not less than once.

In other words, income should be taxed once, *regardless of where* the single levy is imposed, at a rate that does not exceed the residence jurisdiction's rate and is not lower than the source jurisdiction's rate.

But can one really speak about single taxation as ontology as if it was an inherent attribute of cross-border income? The answer obviously is no, and it appears logical to question from where this principle is derived, on what basis it could be justified and for what goal or consideration it should be implemented unilaterally in the international tax policy of each single jurisdiction.

1.2.2.2. Origin and developments of the principle in the international tax framework

The first clear expression of the single tax principle within the international environment can be found in the work of the League of Nations. The commentary to the first model convention drafted by the Committee of Technical Experts in 1927 includes the following statement:

> It is highly desirable that States should come to an agreement with a view to ensuring that a taxpayer shall not be taxed on the same income by a number of different countries, and it seems equally desirable that such international cooperation should prevent certain incomes from escaping taxation altogether. The *most elementary and undisputed principles of fiscal justice*, therefore, required that the experts should devise a scheme whereby all incomes would be taxed *once and only once*.[12] (Emphasis added)

It's not a coincidence that such idea was already envisioned by Adams,[13] the architect of the foreign tax credit adopted by the United States in 1918 (which implicitly embraced the single tax principle by denying the credit

12. Report presented by the Committee of Technical Experts on Double Taxation and Tax Evasion, Doc. G.216.M.85 II, p. 23 (League of Nations 1927).
13. *See* T.S. Adams, *Interstate and International Double Taxation*, in R.F. Magill et al., *Lectures on Taxation*, pp. 112-113 (Chicago Commerce Clearing House 1932): "The

where no taxation was levied by the source state), which also took part in the work of the League of Nations.

Yet, the tax policy developments – from both a unilateral and a bilateral perspective – of the ensuing years showed a greater focus on just one side of the single tax principle, i.e. double taxation relief. As Ault noted, "for tax competition reasons some countries were happy to see structures that reduced the tax burden on their multinational enterprises in their activities abroad, and facilitating double non-taxation was part of the effort".[14] In this regard, Ring explained that double taxation "exacts a high price" that could ultimately erase the profits of a transaction or even demand more than the income actually earned, and for this reason, both governments and taxpayers had a stronger interest in avoiding it. In contrast, double non-taxation is not able to hinder cross-border trade, but just distort its shape.[15]

The efforts of international cooperation have shifted to the prevention of double non-taxation following the publication in 1998 of the OECD Report on Harmful Tax Competition and the subsequent report on the Application of the OECD Model Tax Convention to Partnerships[16] in 1999, and according to Avi-Yonah, starting from the early 21st century, the OECD Model Tax Convention on Income and on Capital (OECD Model Convention) has incorporated the single tax principle.[17]

Finally, the release of the final BEPS package on 5 October 2015 should represent the official commitment by the OECD and G20 to the single tax

state which with a fine regard for the rights of the taxpayer takes pains to relieve double taxation, may fairly take measures to ensure that the person or property pays *at least one* tax." (Emphasis added)

14. H.J. Ault, *Some Reflections on the OECD and the Sources of International Tax Principles*, 70 Tax Notes International 12, p. 1195 (2013). For an evaluation of the inconsistent approach towards double non-taxation (with a special focus on the US system), *see* Avi-Yonah 2014/15, *supra* n. 4.

15. D.M. Ring, *One Nation Among Many: Policy Implications of Cross-border Tax Arbitrage*, 44 Boston College Law Review 2, p. 106 (2002).

16. OECD, *The Application of the OECD Model Tax Convention to Partnerships* (OECD 1999), para. 52 [hereinafter the Partnership Report] explicitly states that the two basic purposes of the OECD Model Convention are the elimination of double taxation and the prevention of double non-taxation.

17. Avi-Yonah 2014/15, *supra* n. 4, at p. 314 makes reference to the limitation-on-benefits provision and the recommendations regarding partnerships and other entities not subject to taxation included *OECD Model Tax Convention on Income and on Capital: Commentary on Article 1* (26 July 2014), Models IBFD [hereinafter Commentary on Art. 1 OECD Model]. Yet, the opposite conclusion is drawn by M. Lang, *Double Non-Taxation – General Report*, in *IFA Cahiers de droit fiscal international*, vol. 89a, pp. 77-119 (IFA 2004).

principle, i.e. to the prevention of both double taxation and double non-taxation. A new Preamble was, in fact, inserted in the 2017 OECD Model Convention, which states that the contracting parties intend to conclude a Convention "for the elimination of double taxation with respect to taxes on income and on capital without creating opportunities for non-taxation or reduced taxation through tax evasion or avoidance".[18] In this regard, it is interesting to quote the words of OECD Secretary-General Angel Gurría, delivered during the presentation of BEPS Project output to be discussed at the G20 Finance Ministers meeting in Lima on 8 October 2015:

> BEPS is depriving countries of precious resources to jump-start growth, tackle the effects of the global economic crisis and create more and better opportunities for all. But beyond this, BEPS has been also eroding the trust of citizens in the *fairness of tax systems* worldwide. The measures we are presenting today represent the most fundamental changes to *international tax rules* in almost a century: they will put an *end to double non-taxation*, facilitate a better *alignment of taxation with economic activity* and value creation, and when fully implemented, these measures will render BEPS-inspired tax planning structures ineffective.[19] (Emphasis added)

Whether or not one agrees with the conclusion that the Model Convention has formally incorporated the single tax principle, it is still reasonable to question the implications of the official commitment by the OECD. Leaving aside bilateral treaty dynamics, why should states adopt this perspective unilaterally, shaping their own domestic systems in accordance with the single tax principle? In other words, on the basis of which policy justifications should a jurisdiction care about what is happening elsewhere when, according to its own system, its tax base is not under threat of being eroded?

1.2.3. The legal justification: Is there an international tax regime?

According to Avi-Yonah, the answers to the questions posed in section 1.2.2.2. are to be found in the existence of a greater "international tax regime" that is part of customary international law.

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18. OECD/G20, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances – Action 6: 2015 Final Report*, p. 91, para. 72 (2015), International Organizations' Documentation IBFD [hereinafter Action 6 Final Report].

19. OECD Centre for Tax Policy and Administration, *OECD presents outputs of OECD/G20 BEPS Project for discussion at G20 Finance Ministers meeting*, Press release (5 Oct. 2015), available at http://www.oecd.org/tax/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm.

Such belief is first grounded in the undisputable recognition of a "remarkable degree of convergence even in the purely domestic tax law of developed countries" that manifests itself in the emergence of a sort of international "common language" (e.g. the concept of residence, corporation or permanent establishment), as well as in similar strategies to address similar issues (e.g. the progressive incorporation of scheduler elements by jurisdictions with a global tax system).[20]

However, the main evidence of the existence of an international tax regime can be found in the bilateral tax treaty network: whether based on the OECD or UN Model Convention,[21] tax treaties share analogous policy concerns, are drafted with similar wording and usually have a higher constitutional status than domestic legislation, hence being capable of limiting and overriding the latter.[22]

The result is that every jurisdiction implicitly accepts and complies with the superior international regime so that the freedom of most countries to adopt international tax rules is severely constrained:[23] could a country ultimately extend its taxing claims over non-residents' foreign-source income? The spontaneous answer is, of course, no.

According to Avi-Yonah's opinion, not only an international tax regime exists, but it would also rise to the level of international customary law, which is commonly regarded as the product of two elements: (i) *diuturnitas*, i.e. a uniform and consistent practice of states; and (ii) *opinio juris sive necessitatis*, meaning the awareness of a legal and binding obligation to follow that practice.

The methods of double taxation relief could constitute an interesting example: although several economists have expressed a preference for a deduction of foreign taxes rather than a credit, states usually still grant a

20. R.S. Avi-Yonah, *Commentary (Response to H.D. Rosenbloom)*, 53 Tax Law Review 2, p. 168 (2000) (*see also* Avi-Yonah 2007, *supra* n. 4, at p. 131). The same observation has been expressed by H.D. Rosenbloom, *The David R. Tillinghast Lecture: International Tax Arbitrage and the "International Tax System"*, 53 Tax Law Review 2, p. 139 (2000), although, as further explainedin this section, his opinion about the international tax system is significantly different.

21. *UN Model Double Tax Convention Between Developed and Developing Countries* (2011), Models IBFD.

22. In this regard, *see also* V. Thuronyi, *International Tax Cooperation and Multilateral Treaties*, 26 Brooklyn Journal of International Law 4 (2001). Quoting the American Law Institute, the scholar states that the OECD Model Convention "has almost acquired the status of multilateral instrument".

23. Id., at p. 170.

credit when the foreign-source income is not exempt. In addition, also the arm's length principle and the non-discrimination principle would fall under the category of international customary law, as they are widely included in domestic tax policies.[24]

In this framework, the single tax principle would constitute "the core principle of international tax law",[25] and being part of international customary law would somehow shape states' policy choices.

These arguments might sound convincing – especially from a systemic perspective – and it is not surprising that Avi-Yonah's voice has increasingly gained support among scholars and experts in the field. Vann wrote about the emerging of an (almost) worldwide consensus in respect of the features of the "international income tax regime", stating that the achievement of single taxation represents the basic goal of the international income tax system.[26] Ring admitted that the concept of an international tax regime is much more fluid than that of a domestic tax system because there is no supranational authority or even a multilateral agreement. However, despite the lack of a binding framework, she identified a common and shared structure underlying the bilateral treaty network, i.e. the work of the relevant international organizations and the domestic provisions regulating the taxation of cross-border transactions, which is inspired and shaped by the vision that income should be subject to a single (no more and no less) layer of taxation.[27] Brauner observed that most rules comprising international taxation are very close to being de facto harmonized,[28] and the single taxprinciple is at the core of tax treaty practice.[29] Lastly, Pistone stated that the BEPS movement is laying the foundation for a "global supranational tax law",[30] and de Melo Rigoni recently proposed a chronology of the international tax regime, divided into three phases, wherein the primary relevance of the single tax principle is constant.[31]

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24. Avi-Yonah 2004, *supra* n. 4, at pp. 496-500.
25. Avi-Yonah & H. Xu, *supra* n. 6, at p. 208.
26. R. Vann, *International Aspects of Income Tax*, in *Tax Law Design and Drafting*, vol. 2, p. 4 (V. Thuronyi ed., IMF1998).
27. Ring, *supra* n. 14, at pp. 104-105.
28. Y. Brauner, *An International Tax Regime in Crystallization*, 56 Tax Law Review 2, p. 263 (2003).
29. Id., at p. 291.
30. P. Pistone, *International Tax Coordination through the BEPS Project and the Exercise of Tax Sovereignty in the European Union*, in *International Tax Law: New Challenges to and from Constitutional and Legal Pluralism*, sec. 8.3.5. (J. Englisch ed., IBFD 2016).
31. de Melo Rigoni, *supra* n. 5.

Yet, the assumption that the single tax principle is the underlying basis/goal of an international customary tax regime is far from being non-controversial. First of all, it has been observed that tax provisions have peculiar features that hinder the formation of international customary law, namely a significant level of technicality and specificity, along with the usual incorporation of qualifications derived from other branches of domestic law (international customary rules are, by definition, formulated in general terms and cannot reach the degree of accuracy of written law). In addition, the harmonization of domestic tax rules promoted by international organizations, the general acceptance of soft law recommendations and the repetition of similar wording among the multiplicity of existing bilateral treaties do not lead per se to the development of international customary rules.[32]

Leaving aside the arguments on the specific features of customary law, one of the most significant rejections of the single tax principle as well as the overall existence of an international tax regime was elaborated by Rosenbloom[33] on the basis of the following observations:

- there is an absence of a supranational authority or multilateral agreement embodying such a system;[34]
- double tax agreements, despite being a "triumph of international law in the field of taxation", are elective, and therefore taxpayers might always refuse their application and invoke their rights under domestic law;[35] and
- domestic law by itself cannot embody the single tax principle if not through an unfeasible case-by-case approach, since tax arbitrage opportunities are different in nature and potentially open-ended.[36]

Given the above reasons, in Rosenbloom's view, there would be no theoretical or legal justification for the single tax principle: "An attempt to 'level the

32. G. Maisto, *On the Difficulties Regarding the Formation of Customary Law in the Field of Taxation*, in *EU Law and the Building of Global Supranational Tax Law: EU, BEPS and State Aid*, ch. 2, (D. Weber ed., IBFD 2017): "No evidence, in fact, exists in state practice that tax treaty rules are viewed as an expression of *opinio juris*, which would make states obliged to apply them even in the absence of a treaty." With regard to the problems occurring in the assessment of the *opinio juris* requirement in respect of international tax rules, *see also* S.N. Menuchin, *The Dilemma of International Tax Arbitrage: A Comparative Analysis Using the Cases of Hybrid Financial Instruments and Cross-border Leasing*, pp. 16-22 (London School of Economics and Political Science 2005).
33. Rosenbloom, *supra* n. 19.
34. Id., at p. 164. In this regard, *see also* Maisto, *supra* n. 31, at para. 2.5.: "Treaties that have been found to crystallize norms of customary international law are generally multilateral treaties, which are extremely rare in the tax field."
35. Id.
36. Id., at p. 165.

playing field' by mandating that foreign persons directly or indirectly entering the U.S. tax system must pay tax at some acceptable level on non-U.S. income is *inconsistent with the practical nature of taxation*."[37] (Emphasis added) According to Rosenzweig[38] and Menuchin,[39] no evidence of the single tax principle consensus can be found in the international tax framework, not even by narrowing the analysis to the mere tax treaty area. In Shaviro's opinion, despite the intensification of international cooperation in the tax field, single taxation upon income deriving from cross-border transactions would be really hard to implement, as the multilateral coordination of all the bilateral interactions between a multiplicity of distinct jurisdictions across multiple dimensions would result in an impossible challenge.[40] Even if its implementation would ultimately be feasible, it would be difficult to rationalize such policy goal, since there is no "direct normative reason to care about the number of taxes that are being levied on a given taxpayer transaction. After all, most of us would rather be taxed twenty times at 1 percent rate each time than once at 35 percent".[41]

Lastly, in the General Report drafted by Lang for the 58th Congress of the International Fiscal Association held in Vienna in 2004, it was concluded that "[t]he existing [double tax conventions] based on the OECD [Model] cannot be easily seen as serving the prevention of double non-taxation. […] The individual provisions of the OECD [Model] *cannot be generally interpreted so as to prevent double non-taxation*"[42] (Emphasis added). As noted by Black,[43] despite the clarifications about the purposes of double tax conventions included in the Commentary first in 1977 and then in 2003,[44] Lang's statement has been confirmed by OECD in the Final Report on BEPS Action 6.[45]

37. Id., at p. 151.
38. A.H. Rosenzweig, *Harnessing the Costs of International Tax Arbitrage*, 26 Virginia Tax Review, p. 588 (2007).
39. Menuchin, *supra* n. 31, at p. 20.
40. D. Shaviro, *The Crossroads Versus the Seesaw: Getting a "Fix" on Recent International Tax Policy Developments*, New York University Law and Economics Working Papers, no. 408, p. 4 (2015).
41. D. Shaviro, *The Two Faces of the Single Tax Principle*, in New York University Law and Economics Working Papers, no. 419, p. 2 (2015).
42. M. Lang, *supra* n. 16, at p. 118. *See also* P. Harris, *Neutralizing Effects of Hybrid Mismatch Arrangements*, in *Papers on Selected Topics in Protecting the Tax Base of Developing Countries*, p. 4 (United Nations 2014).
43. C.M. Black, *The Attribution of Profits to Permanent Establishments: Testing the Interaction of Domestic Taxation Laws and Tax Treaties in Practice*, 2 British Tax Review 2, p. 172 (2017).
44. Commentary on Art. 1 OECD Model, sec. C(1)7.
45. Para. 68 Action 6 Final Report.

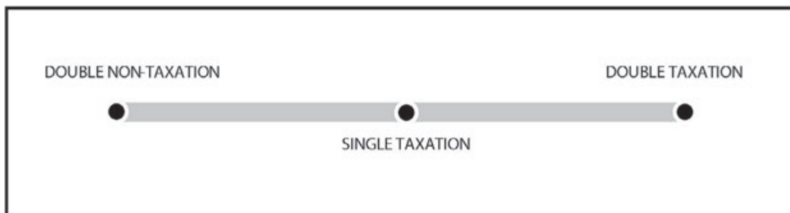
1.2.4. The theoretical justification: Single taxation as a remedy against which "evils"?

1.2.4.1. The intermediate ideal

As highlighted in section 1.2.3., the controversial existence of an international tax regime grounded on the single taxation principle represents the "normative framework" that should constrain and orient the policy choices of states, which are necessarily part of the system and have to comply with the framework's rules. It is now important to understand the rationale behind the principle and the overall international tax regime, i.e. its theoretical justification. What is its exact aim and for what reason should a jurisdiction be concerned that income not included in its own tax base is taxed somewhere else at some minimum level? What policy, quoting Rosenbloom's words, "justifies the elimination of otherwise available [...] tax benefits for the sole reason that the person claiming such benefits (or an economically related person) also enjoys benefits, tax or otherwise, in another country"?[46]

As already mentioned in section 1.2.3., in the view of the supporters of the principle, single taxation constitutes a sort of intermediate ideal between two opposite and equally harmful situations, namely double non-taxation on one end and double taxation on the other. The concepts might be expressed graphically as a linear continuum, as if different levels of intensity of the same phenomenon are taken into account (*see* figure 1.1.).

Figure 1.1.



Let us now examine the "evils" underlying the conditions of "more than single taxation" and "less than single taxation".

46. *See* Rosenbloom, *supra* n. 19, at p. 147. For the sake of clarity, *see also* p. 149: "Why should the U.S. even consider altering the available U.S. interest deduction because Japan has lowered its corporate tax rate or Canada (for example) has adopted particularly beneficial rules for foreign investment?"

1.2.4.2. More than single taxation

Elimination of double or multiple taxation can be considered without any doubt as one of the main goals of the international cooperation in the tax field since the very beginning.[47]

From an efficiency point of view, additional tax burdens on income arising from cross-border transactions give rise to "an inefficient incentive to invest domestically".[48] Furthermore, double taxation generally leads to cumulative tax rates that might be significantly high, with the consequence of hindering international investments and trade.[49] The result is that the system cannot be neutral, neither from a capital-exporting[50] nor from a capital-importing[51] perspective. It is relevant to emphasize that double taxation is not wrong or noxious a priori: "[I]t is unjust only when one taxpayer is assessed twice while another in substantially the same class is assessed but once".[52] This is the reason why the object of the international framework's concerns has always been juridical double taxation (i.e. the imposition of more than one levy of taxation over the same item of income in the hands of the same person). Economic double taxation (i.e. the imposition of more than one levy of tax over the same stream of income in the hands of the same or different persons), on the other hand, occurs in the context of business taxation as an intrinsic implication of the inclusion in the tax mix of both a personal and corporate income tax. It arises equally in domestic and cross-border scenarios and cannot be regarded as unfair.[53] Therefore, the underlying assumption

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47. *See* sec. 1.2.2.2.
48. Avi-Yonah, *supra* n. 3, at p. 518.
49. *See* para. 1 of the Introduction of the OECD Model Convention: "International juridical double taxation can be generally defined as the imposition of comparable taxes in two (or more) States on the same taxpayer in respect of the same subject matter and for identical periods. Its harmful effects on the exchange of goods and services and movements of capital, technology and persons are so well known that it is scarcely necessary to stress the importance of removing the obstacles that double taxation presents to the development of economic relations between countries."
50. Capital export neutrality is defined as the situation "where investors are subject to the same level of taxes on capital income regardless of the country in which income is earned" (*see* IBFD Tax Glossary).
51. Capital import neutrality is defined as the situation "where investments within a country are subject to the same level of taxes regardless of whether they are made by a domestic or foreign investor" (*see* IBFD Tax Glossary).
52. E.R.A. Seligman, *Essays in Taxation*, 10th ed., p. 99 (Macmillan 1925).
53. *OECD Model Tax Convention on Income and on Capital: Commentary on Article 23A* (2017), Models IBFD and *OECD Model Tax Convention on Income and on Capital: Commentary on Article 23B* (21 Nov. 2017), Models IBFD explicitly exclude from the scope of the articles the cases of economic double taxation (*see* sec. C(23)1-2].

of the single tax principle is that most jurisdictions provide and would like to keep both personal income tax and corporate income tax.[54]

1.2.4.3. Less than single taxation

In the light of symmetrical arguments, less than single taxation would be equally undesirable. If cross-border income is taxed less than domestic income or not taxed at all, foreign investments are inefficiently incentivized to the detriment of domestic investments. Hence, the system is once again not neutral.

From an equity point of view, multinational enterprises would receive unfair tax advantages in comparison to small and medium businesses, and at the same time, labour income would be penalized more than business income (labour is far less mobile if compared to capital).[55] These forms of discrimination are therefore related with the perception of abuse and tax morality: "[I]f the taxpaying public perceives cross-border tax arbitrage as an abuse available to (and used by) a limited pool of taxpayers […], then the public support for and confidence in the tax system may be undermined."[56] Lastly, in the case of under or non-taxation, an underlying concern of revenue losses arises.

Yet, as the author intends to demonstrate in sections 1.3.3.1-1.3.3.2., even if one imagines a simple bilateral scenario, it's not easy to identify the jurisdiction to which the loss can be ascribed.

Given all of these considerations, this chapter will proceed by narrowing the focus down to a concrete example of double non-taxation in order to comprehend more effectively what "evil" occurs, for what reasons and to the detriment of which of the involved jurisdictions.

1.3. Reverse hybrids: Why less than single taxation?

1.3.1. Methodological approach: Linking theory and practice

Section 1.2. dealt with the theoretical structure of the single taxprinciple. The single taxprinciple states that cross-border income should be taxed

54. Avi-Yonah, *supra* n. 3, at p. 517.
55. Id., at pp. 518-519.
56. Ring, *supra* n. 14, at p. 122.

neither more nor less than once, and it should be considered the core principle underlying the development of a customary international tax regime since the work of the League of Nations in the early 20th century. Historically, the efforts of international cooperation in the tax field primarily focused on the prevention of double or multiple taxation. Nevertheless, in the last decades, the focus has increasingly shifted to the other side of the single tax principle, and the BEPS initiative clearly aims at tackling the tax avoidance and double non-taxation phenomena.

Yet, according to the author's opinion, the arguments examined do not address in a fully persuasive way the questions previously raised:[57] With special reference to corporate taxation (i.e. an intrinsic form of economic double taxation),[58] what does single taxation exactly mean? Why, from a unilateral policy perspective, should the treatment of cross-border income be compliant with it? The most problematic issue lies in the approach towards double non-taxation cases.

If one now fully agrees with the relevance of the single tax principle and, in particular, with the statement that the BEPS action plan has sealed the OECD's "official commitment" to the single tax principle,[59] trying to apply the theoretical framework with an example might be clarifying. Therefore, this section examines the functioning and the tax outcome of a concrete hybrid structure, as hybrid mismatch arrangements might be regarded as one of the main sources of double non-taxation. Before assessing and applying the OECD's recommendations on how to address such mismatches,[60], the analysis will focus now on what one might call, using Shaviro's words, the "downside departures"[61] from the single tax principle. The purpose is to understand what is "less than single taxation", i.e. for what reasons it occurs and how it affects the jurisdictions involved.

57. *See*, in particular, sec. 1.1.1.
58. Business profits are first taxed in the hands of the corporation and then in the hands of the individual shareholder once distributed, unless a specific provision aimed at eliminating such economic double taxation applies.
59. Avi-Yonah 2016, *supra* n. 4, at p. 12.
60. *See* sec. 1.4.
61. Shaviro, *supra* n. 40, at p. 1.

1.3.2. The Dutch CV-BV structure

1.3.2.1. *Commanditaire vennootschap*: Legal framework

Under Dutch law, a *commanditaire vennootschap* (CV), or limited partnership, is a special type of general partnership that can be defined as the contractual agreement between one (or more) general partner and at least one limited partner. General partners are responsible for the day-to-day management of the partnership, represent the business in its dealings with third parties and are jointly and severally liable without limitations for the obligations or debts of the CV. Limited partners, on the other hand, are generally the funding provider parties and cannot be involved in direct and active management of the business. In this case, the liability is limited to amount of their capital contribution. Pursuant to the contractual freedom principle, no specific substantial requirement is to be included in the CV agreement, also with regard to the identity of the partners. Therefore, both individuals and entities can be partners in a CV, whether they are resident or non-resident.

For tax purposes, the law distinguishes between "closed" limited partnerships and "open" limited partnerships. According to article 2 of the Dutch Corporation Tax Act (*Wet op de Vennootschapsbelasting*), only the latter category is subject to corporate income taxation, while closed CVs are tax transparent and their profits are taxed in the hands of the partners.[62] Therefore, in this case, profit distributions to partners do not trigger dividend withholding tax, and the contribution of assets to a CV is not subject to capital tax. A CV is regarded as closed by the law if the admission of new partners or the transfer of shares is subject to authorization by the unanimity of all the partners. It follows that partners are essentially free to decide whether or not the partnerships should be subject to "flow-through" taxation by simply adapting the partnership agreement.

1.3.2.2. Features of the structure

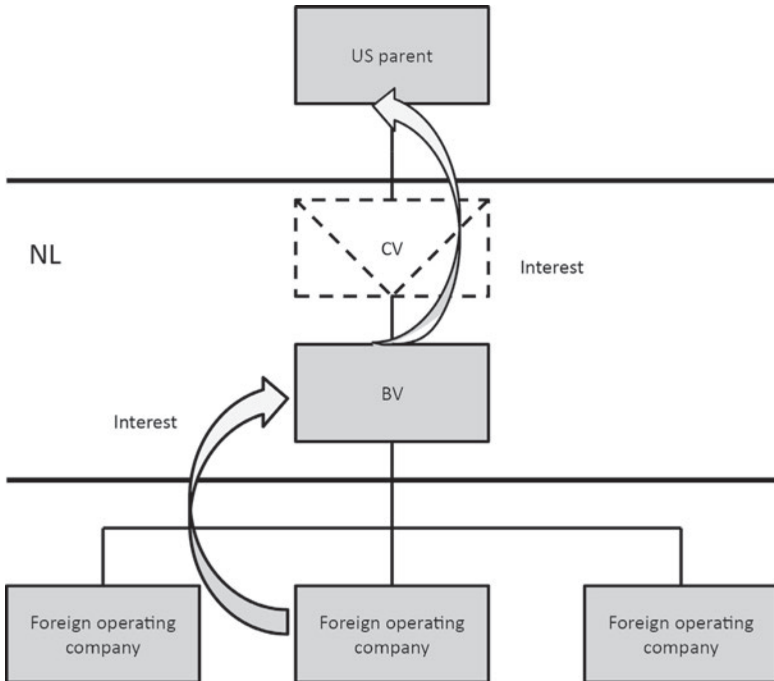
The so-called "CV-BV" structure is frequently used by multinationals, mainly US residents,[63] to avoid taxation on their foreign profits. The US

62. For the sake of clarity, it is proper to specify that profits are still computed at the level of the *commanditaire vennootschap* (CV, or Dutch limited partnership) and then shared among the partners for tax purposes.
63. As further explained (*see* sec. 1.3.2.3.), the US check-the-box rules play an essential role for the successful outcome of the scheme.

multinational enterprise sets up a closed CV in the Netherlands, and the limited partner is generally the head office or another US-resident subsidiary and holds more than 95% of the partnership's shares, while the general partner can be either another US resident or incorporated in a tax haven.[64]

The CV is the 100% shareholder of a Dutch operating company (a *besloten vennootschap* or BV, which is an entity ordinarily subject to corporate income taxation), which usually acts as a holding company for the multinational enterprise's foreign operating companies (which are normally, but not necessarily, EU residents; *see* figure 1.2). Furthermore, the CV might grant loans or might license intellectual property to the BV.

Figure 1.2.



64. *See* J. Vleggert, *Dutch CV-BV Structures: Starbucks-Style Tax Planning and State Aid Rules*, 70 Bull. Intl. Taxn. 3, p. 173 (2016), Journals IBFD.

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