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BEPS: An Interim Evaluation

The article evaluates the OECD BEPS Action Plan and recent progress in light of the key insights of the BEPS: (i) progress can be achieved solely through cooperation, and the existing competition based, unilateral action dominated paradigm is destined to fail; (ii) a comprehensive, holistic approach rather than ad hoc fix-ups is needed for a chance of success; and (iii) some innovations differing from the tradition that is the base for the current regime may be required in order to tackle the evolving new challenges that the regime faces. The article points to the promising aspects of the plan and to the areas where progress seem wanting. It further provides observations on certain steps that the OECD can and should take to increase the chances of success of the BEPS project.

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1. Introduction

International tax talk has never been more exciting. Base erosion and profits shifting (BEPS) by mega multinational enterprises (MNEs), although not a new phenomenon, has recently generated media exposure for the tax planning schemes used by some of the largest US MNEs.[1] This exposure spilled over to other countries and, at the same time, triggered wider political interest in and questioning of these practices.[2] This resulted in a perfect storm, further exacerbated by the world's economic downturn and the need for revenue that did not skip even the richest economies. Thus, the G20, with some of the discussion supplemented by similar discourse in other fora such as the G8,[3] demanded action and charged the OECD with the BEPS project.[4] The OECD was required to provide solutions for the very same

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1. Initially, the tax planning schemes of the largest technology corporations, such as Apple, Microsoft and Google were exposed. *See*, e.g., C. Duhigg & D. Kocieniewski, *How Apple Sidesteps Billions in Taxes* (New York Times, 28 April 2012); J. Drucker, *Google Revenues Sheltered in No-Tax Bermuda Soar to $10 Billion*, Bloomberg, 10 Dec 2012); and R. Waters, *Microsoft's foreign tax planning under scrutiny*, Financial Times, 7 June 2011. Soon thereafter, however, it became clear that the phenomenon is more widespread. *See*, e.g., E.D. Kleinbard, *Through a Latte, Darkly: Starbucks's Stateless Income Planning*, Tax Notes, 24 June 2013, p. 1515. Bloomberg has maintained a now well known website for articles of the kind, titled: The Great Corporate Tax Dodge. *See* Bloomberg, http://topics.bloomberg.com/the-great-corporate-tax-dodge/.
2. *See*, e.g., Hearing before The Permanent Subcommittee On Investigations: Offshore Profit Shifting and the U.S. Tax Code – Part 2 (Apple Inc.), 21 May 2013, available at http://www.hsgac.senate.gov/subcommittees/investigations/hearings/offshore-profit-shifting-and-the-us-tax-code_-part-2.
3. G8, Factsheet: Tax (7 June 2013), available at https://www.gov.uk/government/publications/g8-factsheet-tax/g8-factsheet-tax.
4. G20 Leaders' Declaration at Los Cabos, Mexico (18-19 June 2012), p. 48. *See also* OECD website, http://www.oecd.org/ctp/what-the-beps-are-we-talking-about.htm. The OECD had already been engaged in work on most of the matters related to BEPS, yet the non-compliance related portion of the BEPS project has

problems it has been working on for a long time, yet now it has political backing, but also a deadline – one that is perhaps uncomfortably short.

Some may try to diminish the importance of the BEPS project, arguing that the media exposure is merely populist – as are the political interests – and hence both are likely to disappear when the next story emerges. Others may argue that BEPS is not significant enough to cause concern and, in any event, may not be all that harmful. Or, alternatively, they may argue that governments who support "their" firms competing on the market soberly permit BEPS. Such governments have the ability and sufficient information to change course, yet they choose not to do so in the name of "international competitiveness". Contrary to this line of argumentation, this article argues that the BEPS project is important and requires attention. It argues that the politicians' demand of action will not go away. Consequently, it is more desirable to have the international tax regime improved rather than harmed. The OECD must do "something"; it is the responsibility of the international tax community to make an effort and ensure that the outcome is positive. The tight timeline is particularly worrisome in that regard. A key tactical concern is that the haste would trigger popular, ad-hoc partial solutions based on an already existing arsenal of measures rather than comprehensive and principled rethinking of the yet-to-be-beaten challenges. That would be undesirable and a waste of the political will to reform the international tax regime, when such political will is usually an obstacle for progress in the field.

The BEPS project is also important because reform is substantively necessary. The alleged modest magnitude of BEPS, especially when observed in light of the relatively small amount of revenue involved and the alternative tax planning techniques otherwise available to MNEs, supported a cynical view of the project. Nonetheless, although the empirical research of BEPS is not as extensive and comprehensive as one would expect, and the relevant data available clearly leaves something to be desired, it is significant enough to trigger action.[5] One should add to the benefits of action the opportunity to improve not only the more limited BEPS-negating consequences, but also the international tax regime in general.

Finally, often missing in this discourse is discussion of the legitimacy and stability of the international tax regime. This should not be ignored in these times of crisis and opportunity. Cooperation on BEPS-negating measures may – and should – develop mechanisms for coordination and cooperation in tax matters generally. Involvement of civil society and general transparency could go a long way toward progress. It also should have the benefit of support from governments confronted by political pressure from business. In this regard, it would be a mistake to limit the importance of the BEPS project to the "OECD world". All productive (non-tax haven) countries suffer the consequences of BEPS and consequently all the less-productive countries may find themselves as the targets of at least some of the proposed measures to combat BEPS. Moreover, since essentially all countries either use or are affected by tax treaties, it is likely that the BEPS project's tax treaty consequences would have universal implications.

clearly responded to the G20 call. *See*, e.g., OECD, *Restoring Fairness to the Tax System – Information Brief* (April 2013), p. 15.

5. *See*, e.g., C. Fuest et al., *Profit Shifting and "Aggressive" Tax Planning by Multinational Firms: Issues and Options for Reform*, 5 World Tax J. 3, pp. 307, 314-316 (2013), Journals IBFD. (Reviewing literature and assessing of the question.)

Against this background, the OECD produced an initial report,[6] followed by an Action Plan that dictated delivery of a wide set of measures by two primary deadlines: September 2014 and September 2015.[7] This means that the tax community should expect the release of drafts and the finalization of a large set of measures throughout the first half of 2014.[8] There have been rumors, hearings and some public speeches by OECD officials, yet few concrete conclusions have surfaced about the measures that will be brought forward. Therefore, the window of opportunity to inform the discourse is at the present open, but limited. This article wishes to use this opportunity to provide an interim evaluation of the progress of the BEPS project, based on the above-mentioned information and some educated speculation about its likely outcome, with a view of contributing towards a desirable international tax reform.

This article focuses on the substantive tax treaty implications of the BEPS project. It begins with this introduction of the relevant context for the project. Section 2. follows with an analysis of the key substantive law action items identified by the OECD plan as affecting tax treaties. Section 3. proceeds to briefly examine the administrative action items to the extent they may affect the success of the BEPS project. Section 4. provides an assessment of the BEPS project from a normative perspective based on the project's own fundamental insights and concludes with some modest proposals to include in the project – a re-evaluation of certain longstanding international tax regime norms that cannot be reconciled with the spirit of the BEPS project, yet have continued to dominate the discourse surrounding it.

Directing the spotlight to the innovative insights of BEPS is the primary goal of this article. BEPS is an opportunistic and political project, led by the OECD with unclear goals, uncertain scope and a hasty schedule. Yet, it has already been able to produce some key insights that may contribute to a substantive international tax reform beyond the importance of merely curbing BEPS as previously mentioned.

The BEPS project's most fundamental insight to date has been that international coordination of tax policies is a condition for the success of any substantial reform; and that by definition, unilateral action, regardless of its substance, cannot succeed. This insight stands in stark contrast to the most fundamental basis of the current competition-based international tax regime – a tax regime that has been erected, maintained, and dominated by the dominant OECD member countries and the OECD as an institution through its Model Tax Convention.[9] Recently, this regime has been under pressure, not only as a result of the global financial crisis and the BEPS fallout, but also from developing countries in general and the emerging economies known as the BRICS (Brazil, Russia, India, China and South Africa)

6. OECD Ctr. for Tax Policy and Admin., *Addressing Base Erosion and Profit Shifting* (OECD 2013), International Organizations' Documentation IBFD.
7. There is also a December 2015 deadline for some aspects of the interest expense Action Item 4, harmful tax practices (Action Item 5) and the multilateral instrument Action Item 15. OECD, *Action Plan on Base Erosion and Profit Shifting* (2013).
8. For a more detailed description of the evolving timeline, *see* the OECD's BEPS website http://www.oecd.org/ctp/beps.htm. *See also* the OECD's update webcast "BEPS Action Plan: Update on 2014 Deliverables", available at http://www.oecd.org/tax/beps-webcasts.htm.
9. *See*, e.g., R.S. Avi-Yonah, *Commentary*, 53 Tax L. Rev. 2, pp. 167 and 169 (2000). Note that the current regime is based mostly on decision rules that grant absolute "first bite" tax jurisdiction to one country or the other (source or residence). The only cases where such first bite is limited – articles 10-12 of the OECD Model – are now decimated, since withholding taxes on interest and royalties are all but eliminated, and many treaties provide for 0% withholding taxes even on direct investment dividends under article 10. Moreover, even when withholding taxes are preserved the model is of limiting domestic law rather than a cooperative regime splitting, with consent, the tax bases among countries.

countries in particular. These countries demanded that their interests, and not only those of the OECD members (generally the rich countries), be taken into account in striking the balance reflected by the norms of the international tax regime.[10] Against this background, the outcome of the BEPS project should be viewed as even more important for the various players, yet most importantly for the OECD. On one hand, one may question the decision to charge the OECD with a reform of the failings it has itself been responsible for; on the other hand, the BEPS project presents an opportunity for the OECD to remain relevant and central to the development of the international tax regime, now in cooperation with the above-mentioned countries rather than by way of conflict with them.[11] The challenge would be to gain the support of the traditional OECD powers, whose principled commitment to the competition paradigm does not seem to have wound down, and shift the paradigm towards a more collaborative regime based on this first insight of the BEPS project. It is not just the survival of the international tax regime at stake here, but perhaps also the relevance of the OECD and its dominant members as the key players in the international tax world.[12]

The heart of this insight is the understanding that uncoordinated domestic law actions can never succeed (other than by chance), regardless of their content. The interdependence of the players on the global market therefore requires collaboration. The current, OECD Model-based, regime and its building blocks – the bilateral tax treaties – already provide a form of coordination through standard setting and the moral obligation to conform to the OECD Model.[13] Yet, as is already apparent, this is not enough; current rules are based on tax base allocation rules that are primarily all-or-nothing (source or residence) norms, they do not solve the difficult conflict cases, and provide little, although increasingly more, guidance on implementation issues. This paradigm has failed. What does that mean? It means that primary reliance on domestic law rules – primarily of the anti-abuse variety – alone is clearly inconsistent with this insight. It means that mere "soft law", best practices guidance with no implementation mechanisms is insufficient. It means that an unsophisticated all-or-nothing allocation rules are not sustainable. A paradigm shift would require more sophisticated allocation rules, active collaboration between tax authorities, departure from the bilateral-only structure of the international tax regime, and some form of implementation assuring mechanisms, to name a few. The introduction of such paradigm shift would be the primary test for the success of the BEPS project.

Note that the BEPS project deals primarily with substantive international tax norms, and in that it is different from parallel initiatives, such as the Global Forum on Transparency and Exchange of Information for Tax Purposes (Global Forum). The goal of the latter is to facilitate a one-dimensional flow of information rather than reconcile competing claims. Therefore, one should be careful not to conclude that the many successes of such forum could simply be replicated by the BEPS project. In particular, the reliance on best practices

10. *See*, e.g, P. Pistone & Y. Brauner, *BRICS and the International Tax Regime* (IBFD, forthcoming 2014), Online Books IBFD.
11. The OECD seems to acknowledge this necessity as it has gone out of its way to make the BEPS project process as inclusive as possible. *See* the statements of OECD official, Mr. Russo in the BEPS webcast, *supra* n. 9. The question remains, of course, whether such inclusiveness would interpret itself into revisions of the substantive rules in a manner acceptable by a larger constituency, enhancing the legitimacy of the new international tax regime, or perhaps would simply be viewed as lip service to inclusiveness without genuine reform.
12. For a similar view, *see* P. Baker, *Is There a Cure for BEPS?*, 2013 British Tax Rev., vol. 5, pp. 605 and 606.
13. To cite the OECD chief tax executive, Pascal Saint-Amans, in the OECD webcast, *supra* n. 9.

with some coordination may be very useful to facilitate administrative collaboration, but it has proven to be insufficient for the reconciliation of substantive tax claims.

A second insight of the BEPS project is the importance of a comprehensive and holistic reform rather than the ad hoc reforms that have been typical to date. The OECD cannot be generally blamed for past practices in this context since this is clearly a consequence of politics beyond its control. Nonetheless, a word of caution is due here since, despite the above insight, the OECD and its officials, in both public statements and in the reports to date, have ignored the insight, preferring "pragmatic" and specific "solutions", and avoiding a principled study. These unfortunate developments are exposed and evaluated throughout this article.

A third insight of the BEPS project is that there are certain challenges that have been perhaps underestimated to date. These challenges are primarily those presented by the ascent of the digital economy, but include also transfer pricing; sophisticated financial transactions, including those involving derivative financial instruments; and the growing importance of intangibles in cross-border investment – all stemming from what we call globalization. Past practice has been to not address these issues with new targeted norms, but rather to apply the traditional norms to them by analogy.[14] The BEPS project has not yet been as clear or direct about the necessity of changing this approach.

Implementing these insights into an international tax reform would be an immense achievement. The OECD has already jumpstarted the process and now has an opportunity to make progress toward this goal. This article wishes to support it and contribute some observations on how it should proceed.

2. The OECD Action Plan

By now, the Action Plan is well known. It includes fifteen action items with deadlines for deliverables on 15 September, 2014 or 2015 and a few residual issues scheduled for December 2015. The OECD noted that not all of the action items require amendments to the OECD Model.[15] The article will now evaluate the action items and the OECD's judgment regarding their tax treaty implications.

(1) Action Item 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 characterization of income derived from new business models, the application of related source rules, and how to ensure the effective collection

14. *See*, e.g., OECD, *Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?* (1999).
15. These are as follows: by September 2014, Action Item 2 (Hybrid Mismatch Arrangements), Action Item 6 (Address Treaty Abuse), and Action Items 8 to 10 (Transfer Pricing); by September 2015, Action Item 7 (PE Issues), Action Items 8 to 10 again (Transfer Pricing), and Action Item 14 (Improve Dispute Resolution). Although not directly mentioned, Action Item 15 (Develop a Multilateral Instrument) is obviously also relevant, with a December 2015 deadline for deliverables.

> 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.[16]

Indeed, BEPS is first and foremost about globalization and MNEs. As a business model, MNEs can only be justified by significant intangible content, which is naturally augmented by the ascent of the digital economy and its contribution to globalization. However, not just a macro view justifies focus on the digital economy and transactions in intangibles; such a focus is also dictated by the immediate triggers of the public interest in BEPS – the tax planning schemes of the largest MNEs, all of which have business models heavily relying on intangibles (Apple, Microsoft, Google, etc.). The challenge of this "new economy" is not new, of course. The OECD, together with essentially all countries, struggled with it in the recent past. It was rather successful in reaching some sort of a consensus on some critical issues – mainly those concerning permanent establishments (PEs) – at a time when most countries had remained helpless and unable to act unilaterally. Nonetheless, such success provided only a Band-Aid for a more serious hurt. BEPS has proven that the primary conclusion of the OECD at that time cannot be sustained in the long run:

> As regards the various alternatives for fundamental changes … the TAG concluded that it would not be appropriate to embark on such changes at this time. Indeed, at this stage, e-commerce and other business models resulting from new communication technologies would not, by themselves, justify a dramatic departure from the current rules. Contrary to early predictions, there does not seem to be actual evidence that the communications efficiencies of the internet have caused any significant decrease to the tax revenues of capital importing countries.[17]

The BEPS project acknowledges that even if the above was correct in 1999, it is not so at present. A second immediate conclusion is more of a reminder – that in the context of the digital economy unilateral action did not work in the past and cannot work in the present, necessitating a more serious attempt at international cooperation.

Against this background one must assess the technical challenges of the digital economy. Whereas the 1990's work focused on PE issues, and primarily on the question of whether one can be triggered without people on the ground, the scope is significantly expanded by the BEPS project. It mentions the important interaction and similar problems faced by non-income taxes; it adds to the nexus element in the PE context the difficulty of attribution of profits, including an interesting direct reference to the controversial marketing intangibles; and it specifically mentions the inherent difficulty of classifying and sourcing income from intangibles, and, indirectly, also the difficulty of valuing various intangibles. One immediately notices that intangibles present challenges at all stages of international tax law application and thus of tax treaties. As such, Action Item 1 serves as an overarching action item that affects all others. The most obvious issues would be transfer pricing and PE, yet all action items, including the more procedural ones such as information exchange, should be taking it into account. This is clearly mandated by the OECD's own "holistic" approach.

This approach and the BEPS project's fundamental conclusions show promise, yet the language of Action Item 1 also raises some concern. First, it refers to the difficulty of application of existing rules to the digital economy, and to the need to address these difficulties,

16. All of the quotes in this section are taken from the OECD, Action Plan (2013), *supra* n. 8, unless otherwise noted.
17. OECD, *Are the Current Treaty Rules for Taxing Business Profits Appropriate for E-Commerce?* Final Report, pp. 72 and 350 (1999).

without a mention of the possibility of these rules being simply unfit for addressing the new economy. This is the same trap set by the work in the 1990s and by the refusal to accept that intangibles are different, and that perhaps the old rules cannot be simply tweaked to address the challenges of the new economy. Second, the difficulty – an impossibility in some cases – of valuing intangibles is not specifically mentioned. This is a general flaw of the whole BEPS project that ignores difficulties in implementation. It is also an example of the current most obvious "blind spot" of the OECD that insists on applying traditional valuation in the arm's length fashion regardless of the consequences and refuses to mention when the logic of it may be challenged – as is the case here – or uses the ubiquitous, meaningless "difficult cases … are difficult …" rhetoric without any solution. Awkwardly, the Action Item mentions marketing intangibles that are controversial, but do not represent a key element in BEPS, but it does not mention the most fundamental questions, for example, which country has a claim for taxing an intangible as a "source country".

The OECD is not expected to produce much action on this Action Item. It does not mention it for revision of the OECD Model language or even for coordination of domestic law measures. It is now expected to produce a report or a study of the various challenges and business structures typical of the digital economy. In this case, the evaluation is quite simple: the project's success depends on its willingness to clarify that new norms are required for new challenges, and to forsake its 1990s' conclusions on the matter.

Moreover, surprisingly, and regardless of the most notable BEPS transactions, the OECD says: "[A] different distribution of taxing rights which may lead to low taxation is not per se an indicator of defects in the existing system".[18] On one hand, this may be interpreted as a mild statement to relieve concern among MNEs about the OECD targeting their tax planning "rights". But in the context of BEPS, one should be concerned that a fundamental point would be overlooked: despite the difficulty of determining where value is created, it is not difficult to understand where it is not created. Value is not created where significant R&D does not take place; it is not created where flesh and blood are not present to take all the important decisions about the exploitation of the intangibles, regardless of the distinction between strategic and day-to-day decisions; and it is not created where it is not significantly exploited for the betterment of a large number of human beings. This means that value cannot be determined to be significantly created in places where tax rates are uniquely low.

So, what action may one expect from Action Item 1? A study of the business models of MNEs may be a realistic goal in light of the short time frame, yet one should expect more of the BEPS project, because the OECD itself admits that this is the main challenge. First, as already mentioned, genuine acknowledgement of the challenge is imperative. Yet, even within the boundaries of traditional analysis several obvious issues come to mind, most of which are mentioned at least once by the BEPS project:

Classification and conflicts (often noted as conflict of qualification)[19] – this is primarily a matter of domestic law, yet as BEPS taught us, unilateral action is insufficient in this context. It is the assumption of this article that the OECD expects to address this issue in the context of action Item 2, and indeed hybrid transactions represent the most visible problematic challenges, yet the issue goes deeper. The more fundamental question of classification of income

18. OECD, BEPS Action Plan, *supra* ns. 6 and 8.
19. *See* OECD Model Commentaries, arts. 23, 32.1-32.7.

is not addressed by the OECD and may not be addressed under Action Item 2 since it is not a matter of hybridization. For example, to date the royalty classification has been particularly attractive and sometimes served as a default classification for income from intangibles, yet, at least in the context of BEPS, most of the relevant income would be difficult to distinguish from business income. This has significant treaty implications and it deserves a more serious coordinated consideration, yet beyond hybridization, it is ignored by the BEPS project's overly traditional approach.

Source is an equally important and technically related issue. Again, the BEPS project briefly mentions it and moves on to ignore it. It may be the case that it would not even be addressed by Action Item 2, since, for example, in the case of two countries characterizing income similarly but applying different source rules or applying them differently it is unlikely that Action Item 2 will come into play. It is also an unresolved situation to date in tax treaties. Again, the more fundamental questions are completely ignored: Which countries may claim taxing rights as source jurisdictions? Can one seriously "source" income from intangibles? A serious discussion of these questions requires an evaluation of alternatives – particularly of formulary taxation. The OECD refrains from doing that; presumably this is a consequence of its blind spot, as it simply refuses to use formulary-type-thinking.

The same applies, naturally, to valuation. The most obvious application of valuation is in transfer pricing, which is discussed in more detail below, yet which matters for a variety of tax calculation purposes, including attribution of profits to PEs, discussed next.

This brings us to the more straightforward tax treaty aspects of this Action Item: transfer pricing and PE issues. Transfer pricing is discussed separately below, yet similar, or identical (if one believes the AOA),[20] rules are applicable for the calculations of profits attributed to PEs. A serious study of the digital economy aspects of attribution of profits to PEs has not yet been conducted. The AOA project started with the study of banks and other financial institutions and income, giving little attention to technology-style intangibles that are the primary concern of the BEPS project. This is important since the AOA requires the establishment of internal dealings and the writing of notional contracts regulating the notional transfer of intangibles among parts of a single company. It is easy to see that the difficulty faced in cases of contracts between legal entities is augmented when the legal boundaries among the contract participants are blurred. To date, the OECD was able to provide little guidance on the matter. Perhaps a completion of the intangibles project would be able to bring some progress. It is understood that this project will include some simplification: enhanced use of profit splits, safe harbours, etc., i.e., formulary elements. This is progress indeed, yet, it remains to be seen how it would be coordinated with treaty traditions that have strongly relied on arm's length taxation at the encouragement of the OECD.

In conclusion, the success of the OECD depends on a clear statement of the need to produce new norms for the new challenges, and on the identification of and commitment to engage in genuinely collaborative solutions to the difficult cases, most of which arise from the ascent of the digital economy. This could not happen unless the OECD will be willing to follow up on the BEPS project's third insight, and seriously consider paths that it had rejected in the past, including formulary taxation and distinct and unique rules for intangibles.

20. OECD Ctr. for Tax Policy and Admin., *2010 Report on the Attribution of Profits to Permanent Establishments* (OECD 2010), International Organizations' Documentation IBFD.

(2) Action Item 2 (Neutralize 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.

Unlike Action Item 1 that is likely to produce a mere report, this Action Item is the very essence of the BEPS project and its promise for action and reform. It addresses the most basic BEPS technique and the core of the first mentioned insight – the insight that realizes that rational policy choices taken unilaterally by different countries in an uncoordinated fashion can never succeed, regardless of their logic or rationale. There is nothing new here. In fact, recently the OECD concluded work on the very same problem, resulting in its 2012 report: "Hybrid Mismatch Arrangements – Tax Policy and Compliance Issues". The OECD generally points to this report as a solution associated with Action Item 2, although it has not clarified if more is to come on this. The problem with this approach is that the 2012 report was prepared and published prior to the BEPS initiative. It was prepared under the former OECD approach and was not based on the BEPS insights, such as the one that realizes that coordination is required for the collective action problem.

The conceptual conflict is quite clearly reflected in the conclusions of the 2012 report. These conclusions call primarily for domestic law-based solutions – mainly domestic anti-abuse rules to negate some of the practices identified as abusive. The 2012 report reviewed domestic anti-abuse norms responding to various potentially abusive practices and concluded that they were successful in combating such practices, and therefore that they are the recommended solution to the problem of hybrid mismatch arrangements. This conclusion of course contradicts the first insight of BEPS that unilateral solutions can never (other than by chance) solve BEPS challenges. It is unsurprisingly consistent with the former OECD approach because it was made pursuant to that approach and at a time when such approach dominated OECD practice. As already explained, such domestic action, even if guided by best practice recommendations are not going to generate a sustainable solution.

Now, hybrid mismatch arrangements include various challenges in practice. One group of challenges concerns entity classification issues, including the well known issues – the treatment of partnerships under tax treaties[21] and other transparent and hybrid entities – and

21. *See* OECD Ctr. for Tax Policy and Admin., *The Application of the OECD Model Tax Convention to Partnerships* (OECD 1999), International Organizations' Documentation IBFD; and M. Lang, *The*

the non-traditional relevant norms – the United States' check-the-box regime (CTB) that permits an essentially at-will elective change of entity classification.[22]

A second group of challenges concerns hybrid instruments, such as derivative financial instruments. The challenge is to reconcile the classification of such instruments among the competing or relevant tax jurisdictions. The primary choice here is between debt and equity classification that typically requires a binary, all-or-nothing decision as one or the other, essentially in all jurisdictions.

Finally, a third group of challenges concerns classification of potentially hybrid transactions. These may be financial transactions, principally similar to the derivative instruments already described or transactions involving intangibles, such as software, etc.

As is well known from practice experience,[23] and more recently from studies performed by several countries, with more countries joining the process there is a wide variety of opportunities to abuse such mismatches, leading to the conclusion that only coordination may prevent it.[24] Whatever solution is adopted, some countries are expected to end up winners and others losers in revenue and short-term welfare terms. Therefore, spontaneous coordination is unlikely to occur. Nonetheless, neither the 2012 report nor the BEPS project reports have addressed the challenge of coordination and how would one go about implementing it.

Rather, the reports focus on the technical details and the most obvious issues attracting public attention: transactions that twice took advantage of a deduction for a single expense; transactions where an expense was deducted yet the income generated by it was not included in income; and transactions that generate the benefit of foreign tax credits beyond the taxation of the foreign source income (known as foreign tax generators). These transactions are considered undesirable because of the revenue lost and the unintended competitive advantage they provide to MNEs (manifested in inefficiency and unfairness). Note that it is not obvious that incentivizing MNEs is not per se undesirable, and may very well be a major motivation behind the norm of the current international tax regime. Essentially all countries incentivize R&D and transfers of intangibles, which are the very reason for the existence of MNEs. Essentially all countries use the arm's length principle, and typically the concept of

Application of the OECD Model Tax Convention to Partnerships: A Critical Analysis of the Report Prepared by the OECD Committee on Fiscal Affairs (Linde Verlag Wien, 2000).

22. Treas. Reg. §301.7701-3.

23. The many examples include the so-called DCL cases, where the United States and United Kingdom's respective domestic action failed to remedy a double deduction of losses situation (the very same issue raised by the 2012 report), eventually resorting to coordination via a competent authorities agreement. *See*, e.g., L.J. Greenwald & J.L. Rubinger, *The New U.K.-U.S. Agreement on Dual Consolidated Losses*, 113 Tax Notes, No. 9, (27 November 2006). Other well known conflicts include the differences in corporate residence rules that are not currently resolved. It is generally understood that a simple tiebreaker cannot be designed in such situation where the conflict is substantive. *See*, e.g., R. Couzin, *Corporate Residence and International Taxation* (IBFD 2002), Online Books IBFD. A similar problem exists with respect to partnerships, hybrid and other transparent entities. *See*, e.g., OECD Ctr. for Tax Policy and Admin., *supra* n. 21; M. Lang, *supra* n. 21; and M.H. Seevers, *Taxation of Partnerships and Partners Engaged in International Transactions: Issues in Cross-Border Transactions in Germany and the U.S.*, 2 Hous. Bus. & Tax L. J., p. 143 (2001).

24. *See*, e.g., The Australian Treasury Department, *Risks to the Sustainability of Australia's Corporate Tax Base* (Scoping Paper, July 2013); and S.-E. Bärsch & C. Spengel, *Hybrid Mismatch Arrangements: OECD Recommendations and German Practice*, 67 Bull. Intl. Taxn. 10, p. 520 (2013), Journals IBFD.

the arm's length range, again to the benefit of MNEs.[25] So, not only a normative analysis is missing, but also a serious evaluation of the principles of the current system.

The technical discussion quite clearly takes the perspective of a system that employs primarily a residence based tax system with a foreign tax credit (FTC) to relieve double taxation. The second challenge that fits well in an exemption system is presented in a light critique to exemption as a system, not just to its consequences. This may be a nuance or an unintended outcome of the 2012 report, yet it may affect the legitimacy of the project that should be implemented in a world with many important exemption countries.

This difficulty is exacerbated when the solutions are domestic and specific anti-abuse rules (SAARs), not general anti-abuse rules (GAARs). GAARs are rejected since they primarily target artificial arrangements when the target of this challenge is non-artificial arrangements. Finally, as usual more exchange of information is advocated. This is classic, old pre-BEPS OECD, led by (foreign tax) credit, non-GAAR countries. Quite obviously, the direction of the solutions is clearly in the amendment of domestic laws, ignoring their limitations, the collective action problem, the differing interests, and the domestic sensitivities.

Contrary to the OECD report's position, current treaty practice teaches us that domestic solutions are at best partial and remedial, and at worst they may further complicate the picture and enhance the mismatches that generated the problem in the first place. Further, it teaches us that remedial or small-scale treaty norms, such as beneficial ownership and the conflict of qualification commentaries, are insufficient.[26] It teaches us that not only rule mismatches are problematic, but also mismatches in implementation. It is likely that the single largest contributor to the issues that triggered the attention to BEPS is the distortion created by the implementation of transfer pricing valuation techniques by United States' MNEs,[27] supported by the courts' endorsement of the literal arm's length principle.[28]

In conclusion, hybrid mismatch arrangements represent the classic and most visible cases that the BEPS project should target. The general spotlight on the matter and the emphasis on the need for coordination and at least a treaty compatible solution are positive, as is the general acknowledgement of the need for more tie-breaking norms. Yet, to date the sole action on this matter was reference to the pre-BEPS, conceptually opposite 2012 OECD report that emphasized unilateral, domestic law action, in contradiction to the essence of the BEPS project. The OECD should have realized by now that tweaking the rules as suggested by the above-mentioned report, even in the context of beneficial ownership and conflicts of qualification, may be useful, yet insufficient.

The key issues that must be confronted are as follows:

(1) Corporate residence. For this, it should be understood by now that a simple tie-breaking solution would not work. Moreover, perhaps the most problematic measure – the United States' check-the-box regime – has not yet been mentioned and is unlikely to be

25. *See*, e.g., Y. Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 Va. Tax Rev. 79 (Summer, 2008).
26. *See*, e.g., M. Lang et al., *Beneficial Ownership: Recent Trends* (IBFD 2013), Online Books IBFD.
27. *See*, e.g, Brauner, *supra* n. 26; and Y. Brauner, *Cost Sharing and the Acrobatics of Arm's Length Taxation*, 38 Intertax 554 (2010).
28. Id.

repealed without a multilateral deal. Finally, formula-based solutions might work and hence should be seriously assessed.

(2) Interest deductibility. Although partly separated from this Action Item, it should genuinely be coordinated with the action on it. Again, apportionment should be reconsidered, as well as a principle rather than technical-based solution, or even best practices, since simple convergence is unlikely to emerge.

(3) Intangibles. These must be understood better. Their unique economics should lead the discussion rather than result in analogy to tangible property transactions. The use of simplified mechanisms, including apportionment and safe harbours must be considered regardless of the "loyalty" to the arm's length narrative. Note, however, that caution is warranted: the cost sharing variety rules must be avoided, although they are presented as a mere safe harbour, as the United States' experience teaches us.[29] Reclassifying royalties as business income and including them in a global consolidation solution should be considered, and, in any event, solutions must go beyond the literal bilateral paradigm that has simply proven to be defenseless against BEPS.

In conclusion, this Action Item must produce a normative reform for the BEPS project to have a chance of success. Any solution for hybrid mismatches that goes beyond the current rules would be extremely useful. It must, however, correspond to the key insights of the project. In particular, it must be based on genuine collaboration. Therefore, it cannot rely on the 2012 hybrid mismatches report, which seems to be the direction of the OECD. Such reliance would clearly signal that the project is destined to fail.

(3) Action Item 3 (Strengthen CFC Rules)

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

At face value this is indeed an important component of an anti-BEPS initiative. Deferral is an important feature of tax planning in the United States, as well as most other productive countries. Therefore anti-deferral regimes, such as CFC rules, supposedly make sense. It is not only important but also relevant, since the schemes that brought BEPS to the top of the agenda exposed some of the most conspicuous failures of the United States subpart F regime[30] (its CFC rules) – the inability to capture royalty income from foreign exploitation of intangibles of United States MNEs and the use of the so-called same country exception in the "Dutch Sandwich" scheme, to name two.

Nonetheless, the Action Item and its preamble lack much content. The Action Item calls for general guidance on the design of such rules and general coordination with the rest of the BEPS work, yet without specificity. Presumably, this means that the OECD views the CFC rules as domestic regimes that, perhaps due to domestic (or other) political pressures or even incompetence, do not follow best practices. Again, presumably, the OECD expects to specify such best practices to assist countries in implementing these necessary domestic norms. There is no commitment about specific coordination with other action items since change in this context is primarily, or even solely, based on domestic law reform.

29. Id.
30. This is subpart F of the Internal Revenue Code, §§951-960, that includes the United States' CFC rules.

In the preamble, the OECD added that it had not done significant work on CFC rules in the past. Indeed, the current OECD position is in line with its general position tolerating domestic anti-abuse norms and their consistent (prior) application beside tax treaties, as reflected by part E of the Commentary on Article 1 of the OECD Model (2010). Paragraph 23 specifically permits the use of CFC legislation and declares that such legislation is not in conflict with tax treaty obligations (i.e., that it is not a treaty override), while paragraph 26 clarifies that CFC legislation should only be used for the protection of a country's tax base and, specifically, should not apply to income subject at its source to taxation comparable to that in the country of residence. This has been a rather reasonable pragmatic solution to allow differences among countries to persist in a context with little conflict.

Now, this approach may not be sustainable under BEPS since, apparently, CFC regimes have not been effective. One should, however, question the causality implied here. CFC regimes are a common title for a variety of legal constructs that tax income from foreign investment of resident taxpayers. These include the United States' regime that attempts to capture investment shifted unnecessarily to a low tax jurisdiction. Other countries emphasize the level of taxation, marginal or effective tax rates, and apply CFC regimes below certain thresholds. Yet others apply black or white lists to ensure taxation by either the source or the residence jurisdiction. It is questionable for both exemption and credit jurisdictions to worry much about deferral. Since exemption jurisdictions often switch to credits in cases subject to CFC regimes, the discussion is similar in both cases. The value of deferral is not merely the time value of money supposedly gained, yet in ancillary rules and potential rate changes that make deferral attractive for tax planning.[31] These different methods have slightly different goals and effects and so it may prove tricky to develop "best practices" here.

Moreover, an analysis of the most notorious BEPS schemes demonstrates that the primary damage to the home or residence countries in such transactions (typically the United States) had nothing to do with their indeed weak CFC rules, but rather with their transfer pricing rules. BEPS planning of the sort that led to the project would be significantly costlier if it weren't for the United States' permissive cost sharing regime and its courts' relaxed interpretation of the arm's length standard. Subpart F planning was absolutely minor for such planning.

One may argue that that would not matter if such countries repealed deferral, yet this is beside the point since CFC rules are not about the repeal of deferral; on the contrary, they define the boundaries of permitted deferral. As mentioned by the OECD in the preamble to the Action Item, it is not only the residence country that benefits from effective CFC rules. Indeed, the Google case demonstrates this point, since its "Double-Dutch" scheme effectively reduced the Irish rather than the United States' taxation of Google. Yet, Ireland in that scheme is not exactly the source jurisdiction in the colloquial sense, which, at least, reduces the justification for focusing on CFC regimes within the BEPS project.

The above critique does not mean that tightening the CFC rules may not help in curbing some BEPS through increased costs for tax planning or the revealing of some information,

31. As explained in D.N. Shaviro, *Fixing U.S. International Taxation* (Oxford University Press, forthcoming 2014), available at http://web.law.columbia.edu/sites/default/files/microsites/law-theory-workshop/files/DShaviro.pdf.

yet it should be noted that it is no cure-all and its limited potential in this context must be acknowledged.

Finally, the OECD again shifts the focus to domestic legislation, even if it promises to assist with best practices and perhaps even a coordination mechanism. The differing goals mentioned above and the vagueness of the coordination potential also must raise a concern in this context about the adoption of the first insight of the BEPS project regarding the importance of coordination. The OECD's past actions demonstrate this point, despite its sensibility. Note that this issue also is unlikely to relate to Action Item 4, since deferral and differences in tax rates are not issues that tax treaties deal with or perceive as problematic. It would be a fundamental reform of the international tax regime if treaties were to have a direct say about tax rates in different countries – a reform that does not seem likely in the context of the BEPS project.

In conclusion, it is difficult to see how the work on this Action Item, especially if it aspires to generate best practices, could contribute much to the BEPS project. It is perhaps most important to make sure that the differing domestic rules do not interfere with solution reached for direct taxation of business income proper. The bottom line issue here is the taxation of business proper and an appropriate division of business income among competing jurisdictions. The work on CFC regimes may cause damage if it creates a distraction. Indeed, the fact that the Action Plan divided the work on taxation of business among various action items, much in line with its past, failed paradigm raises concern and skepticism about the chance of progress made on this most important element of the international tax regime.

(4) Action Item 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.

Much like the former Action Item, Action Item 4's language asserts that, at most, it aims at developing best practices. Limitations on the deduction of interest expense are a matter for domestic laws in practice. Tax treaties generally refrain from regulating the deductions side of tax laws. Originally focused on elimination of double taxation and facilitation of exchanges of information, they leave the design of tax bases to the relevant domestic laws. Moreover, the general deductibility rules are quite universal and straightforward within the income tax world, so little dispute has arisen regarding the fundamentals of the deductions rules. The various limitations imposed by different countries' domestic laws on such deductions are much less universal, yet, again, they are perceived as part of countries' domestic anti abuse rules, the differences among which are to be tolerated. Economic double taxation or non-taxation may result, yet there is little agreement on how to handle that issue. Tax treaties are generally unconcerned beyond tangential issues in the context of transfer pricing (ensuring arm's length interest rates), the effect on the level of relief of double taxation, and, relatedly, perhaps treaty abuse via conduit structures.

Nonetheless, the BEPS project has exposed the extent of use of interest expense tax planning by MNEs. United States MNEs heavily employ interest expense tax planning strategies, primarily through related party financing arrangements and the use of derivatives and other sophisticated financing transactions. This discussion shall separate these two strategies. First, United States' interest expense allocation strategies generally wish to "import" deductions, i.e. allocate them against the taxpayer's domestic source income. At the most rudimentary level, it allows a taxpayer to reduce current, usually highly taxed, domestic income. Second, it usually increases the ratio of foreign source income for the taxpayer and increases the ability to "absorb" foreign taxes.[32] Note that such domestic tax base erosion is not generally disallowed. It is solely limited to arm's length interest transactions, to non-excessive leveraging (due to the divergent thin capitalization rules applied domestically, yet very differently, by most countries), and, in some cases, by specific, yet limited, rules.[33] Apparently, the BEPS project concludes that these limitations have been ineffective or inadequate in curbing BEPS to date. Quite like hybrid mismatches, tax planning here exploits rule differences among jurisdictions in order to arbitrage on effective tax rate differences. Therefore, similar action to that of Action Item 2 is expected.

It seems that in fact this Action Item shows more promise than action item 2, at least according to rumor and private and semi-public discussions with OECD personnel. The hope is that at least in this context countries will be able to agree on coordinated solutions that are the hallmark of the BEPS project. These solutions would occur despite the question of the utility and sense of such convergence of rules.

A related issue seems to be destined to a completely different fate. Derivatives and other financially innovative transactions do not seem to be on the agenda of the OECD, although they are mentioned by this Action Item and are part of the hybrid mismatches problem illuminated in Action Item 2.[34] It is not expected that the OECD will do anything in the direction of solving this problem in the BEPS project, since the problem was not particularly highlighted by BEPS and since financial instruments simply do not fit the current paradigm of income taxation, debt/equity all-or-nothing distinctions and tangible property-based international tax regime. Innovative solutions are simply not being considered. Among these solutions one should note in particular the formulary approach. Interestingly, the United States itself uses it as the primary norm for interest expense allocation, but such an approach falls within the OECD's "blind spot" and therefore is ignored in the BEPS project.

In conclusion, despite the diminutive best practices language, it seems that the likelihood of a collaborative solution in this context is higher than in any other part of the Action Plan. This is encouraging even if one questions the utility of such progress in comparison to other issues on the agenda. It is important since it is crucial for the BEPS project to come up with at least some innovative solutions. The clunky old regime leaning on best practices and arm's length lending is not coherent itself, so new solutions are necessary; their provision, consis-

32. *See*, e.g., the *Compaq* case. US: 277 F.3d 778, 28 Dec. 2001, *Compaq Computer Corporation and Subsidiaries v. Commissioner of Internal Revenue*, Tax Treaty Case Law IBFD. rev'g US: TC, 2 July 1999, *Compaq Computer Corporation and Subsidiaries v. Commissioner of Internal Revenue*, Tax Treaty Case Law IBFD.
33. The United States provides an example for the third instance because it uses an assets based formulary interest expense allocation norm. Treas. Reg. §1.861-9T.
34. Beyond the BEPS project, however, *see* OECD, *Agressive Tax Planning Based on After Tax Hedging* (2013).

tently with the first and third insights of the BEPS project, are the key test of the project in this context.[35]

(5) Action Item 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.

This, similarly to Action Item 1 (and others to be discussed below), is an overarching action item. Its language does not include anything that is not specifically included in other action items. Yet, as is well known, there is history here, and not unlike a few other BEPS items, it is a history of relative failure. One must view this Action Item as narrower than its language, limited to a revival of the dwindling OECD harmful tax competition campaign.[36]

This Action Item is therefore about tax havens, off-shore regimes in non-traditional tax havens, and similar rent-seeking, beggar-thy-neighbour regimes in traditionally high tax jurisdictions. These regimes are used by players in the tax competition that is currently the hallmark of the international tax regimes. To date, the OECD has used a carrot-and-stick approach based on its traditional competition-based paradigm to convince all of the above regimes to adopt some transparency measures (mainly in the form of enhanced information exchange). This was based on the views that the competition paradigm is useful, yet should just be perfected, and that transparency is the single and most appropriate device to perfect international tax competition. As expected, this approach has proven a continuous failure. A change of this paradigm to one of enhanced policy coordination was not considered.

One would expect that the BEPS project would be the platform for such paradigm change, as it acknowledges the ineffectiveness of past policies and observe the futility of unilateral action. However, the language of this Action Item proves quite disappointing as it calls for a "revamp" of current efforts, albeit with renewed spirit, with no reflection upon the reasons for past failures.[37] It is unlikely therefore that this Action Item will lead to any progress.

The positive parts of the Action Item are the mention of a "holistic" approach to identifying objectionable practices and the specific mention of the need to engage non-OECD members. In particular, a clear articulation of the essential connection between legitimate tax jurisdiction claims and value creation activities will be very useful. The Action Plan refrains from specifying the regimes most associated with BEPS (most notably the patent box regimes), yet it is generally thought that these regimes will be specifically covered by the deliverables related to this Action Item. Not doing so would clearly harm the legitimacy of the project.

35. E. Traversa, in *Interest Deductibility and the BEPS Action Plan: nihil novi sub sole?*, 2013 British Tax Rev., vol. 5, 607, 614, reaches similar conclusions rejecting more SAARs and advocating contemplation of new solutions.
36. The OECD has even discontinued the maintenance of its relevant website. For a more optimistic view of the campaign, yet one that includes a fair, and not so favourable, evaluation of it, *see* R.S. Avi-Yonah, *The OECD Harmful Tax Competition Report: A Tenth Anniversary Retrospective* (1 August 2008), U. of Michigan Public Law Working Paper No. 115. Available at SSRN: http://ssrn.com/abstract=1194942.
37. *See* J. Englisch & A. Yevgenyeva, *The "Upgraded" Strategy Against Harmful Tax Practices Under the BEPS Action Plan*, 2013 British Tax Rev., vol. 5, pp. 620, 628-629.

Nonetheless, even this positive part of the Action Item raises concern since the OECD first re-clarifies that everything will be based on the current framework and then uses a traditional OECD articulation by mentioning non-members. The OECD reverts to old practices and awkwardly steps beyond its charge (by the G20, not only the OECD members), recreating the "us" and "them" that caused many of the problems for the international tax regime even pre-BEPS. The key "them" countries are now G20 leaders, while many OECD members are not. Again, this is an unfortunate use of language that currently is unproductive and will probably prove meaningless. The inclusiveness of this part of the project may prove the most important element for its success, since there is little likelihood for substantive progress here.

The tax treaties perspective is also awkward. Some specific elements are covered elsewhere in the Action Plan (transparency, exchange of information, etc.) and the identification of objectionable practices is beyond the scope of current tax treaties.[38] Nonetheless, some very important non-technical observations are relevant in this context. It is generally expected that productive, usually high-tax jurisdictions would not enter into tax treaties with tax havens. However, there is no norm that can in any way enforce this expectation. The current competition-based international tax regime probably is not capable of accommodating this expectation.

In conclusion, beyond the new potential inclusiveness of this initiative, if achieved in reality, and perhaps progress on the connection between a legitimate tax jurisdiction claim and productive value creation, this Action Item is expected to disappoint since it appears to focus on proving that past initiatives have not yet truly failed rather than admit such failure, reflect and innovate to give success a chance in accordance with the third insight of the BEPS project.[39] Some remedy could be provided if the OECD will be successful in tackling heads on some of the most obviously objectionable schemes associated with BEPS, including the politically sensitive patent box regimes. A clear commitment to a general principle that special research and development regimes can never be used merely (or even primarily) for the purpose of attracting mobile capital would be a desirable move.

(6) Action Item 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 coordinated with the work on hybrids.

Action Item 6 represents an interesting case because it is another overarching challenge that is relevant to all other challenges if one views the BEPS project as a review of the entire tax treaty based international tax regime. As such, this challenge was not specifically identified in the OECD's initial BEPS report, yet has now become one of the most expedited action items and a key component of the treaty law portion of the BEPS project.

To date, the competition-based nature of the international tax regime has resulted in relatively low tolerance for this notion. In the US tax treaties play a diminished role. This diminished role led one of the top tax treaty experts to reject the idea of treaty abuse by means of

38. In some cases, such practices may be considered treaty abuse, but this abuse is covered by Action Item 6.
39. For similar critique, *see* Englisch & Yevgenyeva, *supra* n. 37, p. 620.

arbitrage.[40] Elsewhere, tests have been developed to prevent the "improper use of treaties", an obviously softer language than abuse and avoidance.

Improper use of tax treaties has been curtailed through mechanisms like the controversial beneficial ownership concept, specific treaty anti-abuse rules in domestic law, and, in specific treaties, limited ad-hoc subject to tax clauses – switchover mechanisms or limitation on benefits (LOB) provisions that indirectly serve as specific treaty anti abuse mechanisms. Little convergence has developed over these measures, even among OECD member countries.

Consequently, the BEPS project states that the bilateral structure of the international tax regime has lost its integrity. The project expresses concern about the use of "third party structures" (presumably the use of entities that are residents in countries where there is little economic justification other than tax for such use) and about the use of multiple layers between residence and source (again, presumably unjustifiably). More specifically, the report identified as problematic low-taxed foreign branches, the use of conduit companies, and the artificial shifting of income through transfer pricing. The suggested response is to more closely align the allocation of income with the economic activity that generates that income. This may become another piece in the (desirable) attempt to fortify a system based on the principle that taxation must follow value creation.

Yet, one could easily note the traditional approach creeping in on this Action Item, seeking domestic law, ad hoc solutions rather than a principled approach. Most of these solutions have been tried, repeatedly, with little success, yet tax authorities cling to even beneficial ownership – a historical accident acknowledged by experts as useless – because they believed it would result in short-term gains.[41] Other solutions, such as "subject to tax" clauses, may be contrary to the policies and interests of some countries, and therefore are unlikely to work absent a multilateral agreement of some sort. Finally, some solutions, such as LOB clauses, are limited in scope as they address limited abuses of the residence concept. Note also that the content of LOB clauses, even in the United States, is unsettled and partially controversial.[42] The reliance on domestic laws is based on ignoring the tensions between treaties and domestic law. Treaty override has not stirred much debate recently, and in the United States it is a matter of constitutional structure, therefore it is not considered too problematic. Yet, other countries are not necessarily partners to this opinion. The OECD pushed the debate into the corner by accepting the application of domestic anti-abuse laws prior to treaty application in the Commentary on Article 1. This simply shifts the debate instead of solving it. Indeed, key norms, such as the United States anti-conduit regulations, remain controversial and are secondary legislation that cannot override the treaty obligations of the United States. Nonetheless, the United States rejects this characterization as treaty-overriding norms and argues that they are simply part of the domestic anti abuse structure.[43]

Moreover, all the triggering cases for BEPS (Apple, Google, Microsoft, etc.) significantly involve transfer pricing manipulation, with much of the manipulation affecting the imple-

40. H.D. Rosenbloom, *International Tax Arbitrage and the "International Tax System"*, The David R. Tillinghast Lecture, on International Taxation NYU School of Law (1 Oct. 1998), in 53 Tax L. Rev. 137, 164 (2000).
41. *See*, e.g., J. Bundgaard, *The Notion of Beneficial Ownership in Danish Tax Law: The Creation of a New Legal Order with Uncertainty as a Companion*, in Lang et al., *supra* n. 27, p. 91.
42. *See*, e.g., J. Clifton Fleming, Jr., *Searching for the Uncertain Rationale Underlying the US Treasury's Anti-treaty Shopping Policy*, 40 Intertax 245 (2012).
43. *See*, e.g., M.J. Miller, *The Evolution of Limitation on benefits, Beneficial Ownership, and similar Rules: Recent Trends and future Possibilities*, 37 Tax Mgm't Int'l J. 719 (2008).

mentation rather than the rules themselves. Transfer pricing, again, was taken out of consideration in the context of the pure treaty action items of the BEPS project, and it is expected that the OECD will again continue to tweak arm's length rules rather than reform the transfer pricing system. Furthermore, the treaty transfer pricing provision of article 9 is an instrumental article, rather than a substantive one. It does little to allocate a tax base among treaty partners and, to the extent it does, it imposes a very soft rule that basically requires separate agreement among treaty partners to achieve the desired result. To date, there has been no indication that this design is likely to be changed or even reconsidered.

The one potential achievement of the BEPS project in this context is the strong double non-taxation language seen to date from the OECD. If the BEPS project accepts the single tax principle as such, it would be helpful in the interpretation of many treaty conflicts. Moreover, arbitrary measures dressed like domestic anti-abuse rules may now be challenged against a clear principle – something that is lacking at present. A clear acknowledgement of so-called double non-taxation as a goal of tax treaties would be desirable; accepting the single tax principle as the backbone of tax treaty law would be even more desirable.

Finally, the awkward statement of intent, "preservation of the bilateral structure", should be reconsidered. If this is indeed a multilateral project intended to provide useful solutions through coordination, it is the coordination and multilateralism that must be emphasized from the beginning and not bilateralism as such. This does not mean that an all-or-nothing multilateral treaty is the sole measure for the success of the project. The tax community may need to wait some time until it materializes, if it materializes at all. It means that there could be areas beyond exchange of information where convergence has already occurred and a multilateral process might assist in converting that convergence to a useful agreed-upon instrument.[44]

(7) Action Item 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.

The tax treaty work on PE status is always in play – the PE concept being the hallmark of the important taxation of business income regime under tax treaties. When BEPS came into the limelight, the OECD was in the process of a major study of the PE concept. This study encompassed two separate projects: the revision of Article 7 and its Commentary according to the "Authorised OECD Approach" (AOA) and a re-evaluation of article 5 that was expected to result in a significant revision of the Commentaries on Article 5. The latter project was put on hold, giving preference to the BEPS project, particularly to Action Item 7.[45]

The issues identified in this context by the BEPS project are as follows:

(1) Countries interpret the agency PE rules so that sale of goods may be negotiated without source taxation. This leads MNEs to replace source state distributors with commissionaire arrangements having little to no real change in operations.

44. The author argued that gradual convergence is possible and useful. *See* Y. Brauner, *An International Tax Regime in Crystallization*, 56 Tax L. Rev. 259 (2003).

45. *See*, e.g., S. Soong Johnston, *OECD's Final Work on Permanent Establishments on Hold for BEPS, Official Says*, 2013 WTD 108-3 (3 June 2013).

(2) MNEs artificially fragment their operations among multiple group entities to qualify for the "preparatory and ancillary" exceptions to PE status.

Note that the OECD identified very specific instances where it saw abuse, but only with respect to the technical elements of article 5, article 7 and the interaction between articles 5 and 7 – that may perhaps belong to the transfer pricing action items – were completely ignored.

One immediately notices the language that is both very general and very specific to the issues identified. Also, the treaty side of the OECD (presumably WP1) gives way to the transfer pricing side (WP6) on the analysis of attribution of profits, much in the same way that the article 7 work was done and led by that side of the OECD – as if the questions of status and attribution are independent of each other. This is the traditional view, yet it is rather controversial. A second immediate observation is that many of the issues that occupied the time and attention of the OECD's pre-BEPS project are not being addressed; these include[46] the meaning of the "at the disposal of" language, the use of sub-contractors, the time requirements, the presence of foreign personnel in the host country, the meaning of "place of management", the "to conclude contracts in the name of the enterprise" language, the entrepreneurial risks and more. Finally, despite the contribution of political pressure by developing and emerging economies that led to the BEPS project, there is little attention to the main sources of complaints by such countries against the current design of the PE regime by the OECD. The Action Item does follow a general direction of protecting source taxation, yet it does not address the specific issues that countries such as India and China have been raising in the last few years. There is no consideration of the service PE concept, no discussion of changes to construction PE rules, no mention of the digital PE option (although that may come up in Action Item 1, which is more generally devoted to the challenges posed by the digital economy) and, finally, no re-evaluation of the agency (or the subsidiary) PE concept as a whole.

This Action Item seems to be heading toward a lowering of the PE threshold, which should result in more source-like taxation. Yet, the focus on issues that quite clearly are of concern to the traditional OECD-dominant countries rather than typical source jurisdictions, especially when such choice ignores prior, much more comprehensive work, raises concerns about the legitimacy of the BEPS project. It is inconsistent with the second insight of the project and its promise for a holistic approach and inclusiveness. The focus on agency PE and commissionaire arrangements, although politically understandable, is also risky, since its goal is quite straightforward – that commissionaire arrangements should not be utilized to circumvent source taxation – any result but for a clear statement to this effect would be transparently unacceptable. Finally, the second point mentioned, about fragmentation of business, signals a reversal of policy within the OECD. This may be warranted, yet requires a clear statement to be useful. Finally, continuing to ignore article 7 and the interaction between articles 5 and 7, signal a continuing insistence on the AOA. The controversial nature of the AOA may spill over to the BEPS project and discount the promise for inclusiveness and new thinking, contrary to the second and third insights of the BEPS project.

46. *See* OECD, *OECD Model Tax Convention: Revised Proposals Concerning the Interpretation and Application of Article 5 (Permanent Establishment)* (19 Oct. 2012 to 31 Jan 2013). Also ignored are the implications of BEPS on the service PE rules that are not part of the OECD Model yet exist in many treaties and are important for emerging and developing countries.

(8) *Action Items 8-10 (Assure that Transfer Pricing Outcomes are in Line with Value Creation)*

These action items are perhaps the most interesting of the Action Plan. There should be little doubt that transfer pricing is the primary element of BEPS planning. It also was the key to the transactions that led to the universal interest in BEPS and the OECD's BEPS project. The essence of these transactions is the so-called "movement" of their intangibles – actually the rights to exploit these intangibles outside the United States – to a low tax jurisdiction, primarily Ireland, but also Luxemburg, Switzerland, etc. This was done through a cost sharing scheme that is still unique to the transfer pricing regime of the United States. Such movement shielded from US taxation – both directly and indirectly – the income from the exploitation of these intangibles. Next, the MNEs would structure their business worldwide in a manner that would maximize the profits shifted to these low tax jurisdictions at the expense of the jurisdictions where they operate using multiple schemes. These schemes all belong to the BEPS project, yet first in importance is the simple use of transfer pricing, since the arm's length based transfer pricing is inherently biased in favour of these MNEs and this bias is particularly pronounced for MNEs with larger intangible components in their businesses.[47]

Indeed, the insufficiency of current transfer pricing for intangibles rules has been acknowledged by the OECD and acted upon prior to the BEPS project.[48] Moreover, unlike the PE project, this project seems not to have been shelved for the BEPS project. This is a positive sign,[49] since it is the heart of the BEPS issue and, appropriately, Action Item 8 (Intangibles) is the first transfer pricing-related action item. Action Item 8 reads:

> 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.

The intimate relationship between the intangibles and BEPS projects obviously makes sense and the same experts will, and should, work on both. Yet, the same concerns that apply to the BEPS project as a whole are even more conspicuous in this context. First, the competition based approach of the pre-BEPS world has been the basis of all OECD work and the work on this project in particular. The OECD will have to see how it could progress in the intangibles project, embracing the first insight of BEPS about the necessity of genuine coordination of policies. Although critical of the OECD work on transfer pricing to date, this article does not assert that the change of approach necessarily requires scrapping the work done to date; it just requires a re-evaluation and enhancement of the appropriate elements toward which the OECD has been leaning anyway – such as a more prominent role for formulary elements like profit split mechanisms – and an enhanced collaboration in assessment and enforcement.

47. *See*, e.g., Brauner, *supra* n. 25.
48. The OECD published a discussion draft first in June 2012, and a revised draft in July 2013. *See* OECD, *Discussion Draft on Transfer Pricing Aspects of Intangibles* (June 2012); and OECD, *Revised Discussion Draft on Transfer Pricing Aspects of Intangibles* (July 2013).
49. Note that differently from the use in Action Item 2 of a pre-BEPS report (on hybrid mismatch arrangements), the use of pre-BEPS work here is not only not problematic, but also desirable. The work on transfer pricing for intangibles is not related (at least in this preliminary stage) to the type of countries involved or their particular interests. Rather, it is in the process of establishing the principle – a norm that makes sense, is administrable and that seems to be fair and worthy of legitimacy.

The test would be the ability of the OECD to innovate and add to the arsenal developed to date and to adapt what it has to the new insights.

A second point addresses the most important additional element required – the addition of formulary elements. Although important, it is the elephant in the room that has unfortunately fallen into the OECD's previously identified "blind spot". The addition of formulary elements, some of which the OECD has been considering anyway, and dressing it with thinly veiled arm's length rhetoric, is essential and particularly appropriate to the BEPS project. If the OECD is unable politically to overhaul the system, it may accept formulary solutions for what it calls hard-to-measure intangibles – the most important elements of the challenges faced.[50] Further, formulary solutions more visibly mandate coordination of assessment[51] in the spirit of the BEPS project. Moreover, politics can go both ways, and the current resistance to change that has presumably been led by functionaries from a few countries and by MNE lobbyists now may be confronted using the power of the G20 mandate for change.

Finally, it is not only the fundamental paradigm that has changed, but also the power structure and interest map. This may have been true even before the BEPS project due to the pressure and growing prominence in the OECD of non-members China and India, for example. Yet, the BEPS project is a G20 project, and it is a project with a global, universal view of the interests of the productive countries, not just the developed or even the most powerful countries in mind. Adapting to this change of perspective may prove very difficult for the OECD. If it simply proceeds with its intangibles work, it will expose itself to criticism and illegitimacy by both the immediate principal – the G20 – and the regular critics, such as India, Brazil, academics, etc. Yet, it would be very difficult to demonstrate a change in course while preserving the positive aspects of its work to date and appeasing all critics. The most natural course of action would be collaboration with the BRICS countries. However, that would be difficult to achieve within the short timeline that has been set. Some differences are rather fundamental and go beyond transfer pricing (the differing source rules being a primary example). But, even more problematic is the fact that the potential partners, such as the BRICS countries, are not coordinated and employ various and differing approaches to the same issues. A more appropriate approach for the OECD would be to directly assess some of the alternative solutions used or suggested by critics and either adopt them or seriously explain why not or just why not now. These may include the use of safe harbours, predetermined margins, etc. Of course, this requires a relaxation of the arm's length rhetoric already discussed.

The language of Action Item 8 feeds further concern. Of course, it begins with the dictation that arm's length is the consensus and cannot be breached, even if it fails. Regardless of the rhetoric, it is past time for the OECD to relax the escalation of this distinction between arm's length and formulary taxation. The language of the Action Plan may lead one to falsely believe that arm's length taxation is the end, not the means, toward appropriate and stable allocation of tax bases among countries. This is harmful, as evidenced in the United States,

50. Such partial reform is not impossible as demonstrated by R.S. Avi-Yonah & I. Benshalom, *Formulary Apportionment: Myths and Prospects – Promoting Better International Tax Policy and Utilizing the Misunderstood and Under-Theorized Formulary Alternative* (16 October 2010). U. of Michigan Law & Econ, Empirical Legal Studies Center Paper No. 10-029; U. of Michigan Public Law Working Paper No. 221, Available at SSRN http://ssrn.com/abstract=1693105.

51. This assessment is intellectually required also in the arm's length based regime, yet it is ignored, except for the very weak application of article 9 in tax treaties.

where the government suffered defeat in a sensational case because some judges understood that long-lasting position to falsely be so.[52]

Yet, if one ignores the rhetoric, perhaps there is some promise. First, the acknowledgement of the need of "special measures, either within or beyond the arm's length principle" and "special measures for transfers of hard-to-value intangibles" clearly reflects an understanding of the failure of the current regime and of the fact that the titles used are not important.[53] Second, the Action Plan, contrary to the general unprincipled character of the BEPS project, declares in this context a clear purpose: "Assure that transfer pricing outcomes are in line with value creation". This principle is rudimentary, yet one can work with it. It is apparently inconsistent with some other language and current rules and it may not be easy to implement. Yet, it is clear and it must seem to be fair, and thus legitimate. If this principle achieves legitimacy and acceptance, the work on implementation may have a chance of success, regardless of the means. The OECD must now clarify this principle and hope for acceptance, yet that may prove difficult. For example, when an intangible is completely designed and perfected in one country but is solely exploited in a second country, where is value created – in the first or the second? If in both – how to split the value creation between the two jurisdiction? Obviously, straightforward arm's length is helpless when this is done within a single firm, and the same problems that exist today are repeated. Yet, the principle may be useful to get rid of some issues, such as the question whether the workforce in place is relevant for transfer pricing study – the OECD is currently reluctant to accept this, yet it clearly creates value.

This brings us to the first item mentioned by the Action Item: the definition of intangibles. The OECD has done a lot of work on that and insists on lumping all intangibles together in one issue group with one set of rules. Yet, this question's relevance to BEPS seems minor, and the insistence on ignoring the major differences between types of intangibles seems problematic in light of the value creation principle. For example, the contrast between legally protected intangibles, such as patents (intellectual property "IP") and non-protected, firm specific intangibles demonstrate the very different value drivers that at present are ignored and treated equally based on the transactional fiction of arm's length.[54] It seems more effective to develop specific norms for specific items of income that the OECD wishes to exclude from the application of the general norms rather than trying to artificially define this difficult-to-define group of things called intangibles. The second item declares the principle mentioned above, and it is really the heart of the OECD's intangibles project already discussed. The same applies for the third point about special measures for hard-to-value intangibles, for which the OECD should be more open-minded. Open-mindedness would at least reduce some of the above-mentioned "blind spots" and would expand the OECD's "field of vision". Finally, the mention of cost contribution arrangements (CCA) is particularly interesting since little discussion has been devoted to it. CCAs under the Transfer Pricing Guidelines

52. *See* Brauner, *supra* n. 28.
53. G. Kofler, *The BEPS Action Plan and Transfer Pricing: The Arm's Length Standard Under Pressure?*, 2013 British Tax Rev., vol. 5, pp. 646 and 656, discusses the possibility of using the US statutory concept of "commensurate with income". He notes that the ability to go beyond arm's length permits this without the hurdle presented by the argument that it is not arm's length compatible. This is true and possibly useful. It has the perceived benefit of compatibility with US law. The problem is that this concept is hardly implemented in the United States itself. This is not just because of its arm's length incompatibility but also the difficulty of implementation and the unease of ex post determinations that is common in our legal system.
54. *See*, e.g., Brauner, *supra* n. 25.

("TP Guidelines" are not akin to American cost sharing. The OECD should be extremely cautious not to fall into the trap of adopting rules similar to those of the United States. It is these rules primarily that generated the most offensive transactions that led to the BEPS project.[55]

The next Action Item introduces two specific intangible elements that are difficult to use within the current paradigm. Action Item 9 (Risks and Capital) reads:

> 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.

Capital is another Achilles heel of arm's length taxation since it is obvious that the circumstances of MNEs are fundamentally different from those of unrelated corporations, even when these corporations would engage in similar transactions. The work on article 7 has exposed this difficulty and there the OECD simply punted, not requiring maintenance of separate equity levels by the company and the PE for all purposes (at least for now). It is difficult to see how the OECD could achieve progress here within the framework of literal arm's length. This skepticism goes even deeper due to the almost militant protectiveness of the AOA by OECD officials. The most likely outcome would be no action, which is obviously contrary to the insights of the BEPS project.

Risk presents a trickier, yet not less difficult case, since it is a matter of legal creation completely controlled by the taxpayers, supposedly regardless of value creation. Yet, at the same time, one cannot ignore the contribution of risk taking to value creation that was declared the "normative principle". The only way to align the principle with the value creation norm would be to use proxies to risk taking, which again requires rethinking of current methods and perhaps acceptance of innovations. Again, this article is skeptical of the OECD's willingness to follow the BEPS project's insights in this context, especially when it has recently dealt with this very issue in both the AOA and its business restructuring projects, protecting the outcome of these projects against ample criticism. Nonetheless, these are the difficult cases that require universal solutions and innovation, and this is where the integrity of the OECD running the BEPS project will be most challenged.

Action Item 10 (Other High-risk Transactions) reads:

> 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.

This is an interesting action item and it demonstrates the struggle within the OECD on this matter. On one hand, this is essentially covered by Action Item 8 above, yet the OECD chose to separately emphasize the situations where literal arm's length does not make sense since there are no market comparables and none can occur. In that sense, nothing new is

55. *See also* Brauner, *supra* n. 28.

expected to come from this Action Item; although it does mention specifically profit split, it is mentioned as an honourable defeat solution to save face for the arm's length apologists.

The Action Item mentions, however, two additional matters that may be important. The purpose of the mention of recharacterization for transfer pricing purposes here is unclear. If this means encouragement of the use of legal constructs, such as analogy, etc., to mould non-market transactions into the shape of market transactions solely for the purpose of applying traditional arm's length methods to them, then this comment raises concern. It is exactly this approach that has failed to date and requires re-evaluation. Constant promises that "this time we will get it right" should not be accepted.

The other comment is much more focused and mentions specifically base erosion payments that have caused BEPS and are viewed as problematic and inappropriately dealt with under the current regime. These payments involve primarily the relationship between the brain and mind of the firm and the rest of it. Their serious evaluation requires a better understanding of intangibles and related services and their fit in the current legal scheme that, for instance, heavily relies on ownership (this is rather ill-fitting to describe the economic function of intangibles in general due to their cheap scalability and significant uncertainty and unpredictability).[56] The problem that the OECD faces is not conceptually different or separate from the general policymaking for intangibles. Yet, in this particular case there is an alternative course of action, even if it is temporary (which may be necessary due to the tight timeline). That alternative is to address particular items of income such as those mentioned ad hoc. The political attention may allow the OECD to introduce technical fixes that would otherwise be difficult to pass. Of course, it would be desirable that such fixes take into account the larger picture and goals, and not simply serve as another layer of obstruction to fortify the hold of arm's length thinking on the international tax regime. Management fees, for example, never should be viewed as the simple provision of services, which is often camouflaged with simple and minimal cost-plus margins. A true value creation approach would acknowledge the contribution of management as the heart and mind of the firm. At the least, significant profit margins should be allocated to it, based on the value creation logic and the relative immobility of the humans that comprise such management. If one wishes to use profit split rhetoric or a formula is a separate question that is beyond the scope of this article.

Finally, the legal design of transfer pricing rules within the general structure of the international tax regime is awkward and undisciplined. An analysis of the reasons and history for this is a matter for separate study. Regardless, although it is almost generally accepted that tax treaties encompass commitment to arm's length based transfer pricing, the details of which are a matter for domestic law, an essential consensus expects them to be compatible with the TP Guidelines. The actual treaty device is merely complimentary to this construction. Article 9 requires a loose obligation to respect a treaty partner's transfer pricing determinations. The levels of commitment here vary, yet they vary between loose and extremely weak. A principled approach that seems to be preferable, at least to a section of the OECD experts working on these issues, would require a significant revision of the architecture of the relevant rules, regardless of the content of the principle chosen.

56. *See*, e.g., Brauner, *supra* n. 25.

3. The Supporting Cast

The substantive portion of the Action Plan is supported by five action items that are primarily administrative. They are about reporting, dispute resolution, the basic structure of tax treaties and the possibility of infusing multilateral measures to these primarily bilateral devices. This section briefly evaluates these action items, although they are not its primary focus. Instead, the analysis in this section concerns the relationship between these action items and the substantive action items and the manner in which they support or conflict with the purported goals of the BEPS project. It does not intend to comprehensively evaluate them for their own standalone purposes. The first item, discussed next, is a good example of this approach. It deals with the core of the traditional OECD approach which focuses on information as the cure-all for inappropriate tax planning.

(1) Action Item 11 (Establish Methodologies to Collect and Analyze 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.

This is both a very general and a very specific Action Item. It calls for enhanced transparency, which, although desirable, should be realistically viewed. The OECD has traditionally pursued exchange of information as a panacea and the sole appropriate action for fighting tax evasion. The work on information exchange has been delegated to the Global Forum and should probably affect the BEPS project only marginally. Therefore, this article only adds a couple of comments in this context. The role of civil society has been neglected in the project despite its importance in raising the awareness of BEPS. The most prominent proposal coming from NGOs and similar organizations has been country-by-country (CBC) reporting.[57] The article discusses CBC here and not under Action Item 13 where it is haphazardly mentioned, since it views its importance as reaching beyond another method of transfer pricing documentation. It is critical to emphasize that CBC is important for both legitimacy and substantive reasons. Restoring the confidence of the public in the international tax regime must be a key goal of the BEPS project, thus the importance of legitimacy. Yet, CBC reporting is also important since it will be readily available to countries in their assessment of the operations and tax planning of firms from a wider and transparent perspective. The most important element, however, is also the most fragile: CBC reporting must be publicly available; otherwise, it is certain to become ineffective from the enforcement perspective and irrelevant for the important, yet often ignored, legitimacy purposes. It is unacceptable for the tax authorities to keep it secret or, worse, to claim that it is unnecessary since the tax authorities already have the information. Finally, CBC reporting may assist the development of multilateral treaty solutions that are currently handicapped by the partial (often bilateral) perspective of available information.

57. *See*, e.g., the relevant webpage on the Tax Justice Network website available at http://www.taxjustice.net/cms/front_content.php?idcat=144.

The more specific action inferred may even be more important for the success of the BEPS project. The language of the Action Item implies that the OECD intends to develop an accountability mechanism. The OECD also took the effort to give concrete examples for data to be collected, and although it mentions the need to balance administrative costs and privacy issues, it does not refer to the latter as exceptions but rather as balancing factors. This may mean that the OECD is serious about installing this accountability mechanism. Accountability is a critical factor in the success of international reforms. It may signal a serious commitment to reform on the part of the OECD. This, if true, should be a major step forward for achieving legitimacy and for actually seeking reform.

(2) Action Item 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.

Similar to the point made above, the analysis of this rather unclear Action Item is beyond the scope of this article, and deserves a separate study. Yet, it should be questioned whether the BEPS project is the right place to establish what would seem to be delivered in the form of best practices. The Action Item mentions similar experiences in several countries, yet these experiences are very diverse in both content and success. This Action Item may be useful as part of the general collaborative effort, yet it is doubtful that it would contribute to the general evolution of the international tax regime otherwise. Diverse and sporadic reporting may exacerbate rather than alleviate BEPS, as it is likely that different countries would employ different rules on these very sensitive matters with differing commitments to, and success in, their enforcement; such unilateral action was the target of the BEPS project in the first place. This risk may not be worthwhile, especially when the value of the reward is questionable.

(3) Action Item 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 MNEs provide all relevant governments with needed information on their global allocation of the income, economic activity and taxes paid among countries according to a common template.

The comments made on article 9 above apply to this Action Item.

(4) Action Item 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.

It is unclear what direction the OECD will take on this matter. It has promoted mandatory arbitration with little, or perhaps slow, success to date. The collaborative element may cause some prior options for reform of the mutual assistance procedure (MAP) to resurface. One that comes to mind is the proposal to establish an independent tax treaties interpretation board that would free treaty interpretation from the rigid institutional constraints of the OECD without harming the stability of the international tax regime.[58] Such a board could also assist, perhaps in a non-mandatory fashion, in the resolution of difficult treaty disputes, especially when the implications may go beyond the specific facts. A holistic and innovative approach requires the embedding of innovative solutions such as the above into a multilateral framework that is the subject of the next Action Item.

(5) Action Item 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.

The current hastened time frame will not allow for a fundamental reform of the international tax regime. Indeed, the OECD seems not be aiming at delivering anything tangible on this Action Item, but rather launching a working framework besides the OECD to contemplate solutions. The essence of the Action Item is both obvious and appropriate: a cooperative approach and adaptation of the international tax regime to the market realities require an expansion of scope beyond bilateral arrangements. Tweaking bilateral arrangements for triangular cases, for example, has proven either insufficient or unsatisfactory. Again, the difficulty would be that a change of paradigm would require thinking beyond the traditional OECD tools of the trade. The question will be whether the OECD would be willing and able to do that.

Finally, note that multilateral arrangements and convergence do not have to be an all-or-nothing matter or reform. The unique structure of the international tax regime permits gradual progress.[59] A major achievement of the BEPS project would be to establish a forum for the discussion and assessment of multilateral tax ideas. Other options include perhaps a more “modular” model rather than the OECD’s rigid single format. The strength of the OECD model is not in its strict singularity but in the standardization and the accessibility it provides. These may be preserved, albeit in a different, more collaborative and multilateral format, and it seems that the OECD has adequately started the process. It has already indicated that the preliminary conclusion is that the project is feasible, which is encouraging. Establishing a forum for international tax policy coordination is the most important achievement the OECD can accomplish here.

4. Conclusion

The first response of many to the BEPS project was puzzlement over its goals. It seems to be about everything to do with international tax and nothing to do with it at the same time. The political roots of the project may have necessitated this; the interesting question is whether

58. *See* K. van Raad, *International Coordination of Tax Treaty Interpretation and Application*, 29 Intertax 212 (2001).
59. *See* Brauner, *supra* n. 45.

the project's unprincipled origins will dominate the outcome. If so, the project will likely dissipate into obscurity.

Nonetheless, despite the ample critique of the project expressed by this article, to date some positives must be identified. One would hope that these will dominate the deliverables of the OECD rather than the undesirable features of the project. First and foremost, the key insights of the project are all positive and important: (i) progress can be achieved solely through cooperation, and the existing competition based, unilateral action dominated paradigm is destined to fail; (ii) a comprehensive, holistic approach rather than ad hoc fix-ups is needed for a chance of success; and (iii) some innovations differing from the tradition that is the base for the current regime may be required in order to tackle the evolving new challenges that the regime faces.

Overall, the BEPS project does not seem to be very compatible with the promise of these insights. Although it has not yet delivered operative measures, one generally gets the impression of strong attachment to OECD tradition, a resistance to innovation, a lack of a change in perspective (being in this project not only the representative of its rich country members), and a more general failure of leadership in the avoidance of even a rhetoric of a clear, comprehensive and purposeful action.

More specifically, at present it seems that only one or two matters may be met with substantive reform that is likely to indeed be achieved through a collaborative effort. Deductibility of interest expense is the consensus leader here, yet it should be noted that these rules are primarily domestic law based, and their likely impact on BEPS may be modest. Perhaps the PE definition and related article 5 matters in continuance of the existing expansive OECD work will achieve some resolution, yet, there are serious questions raised about the direction of this work, as discussed above. Finally, perhaps there is hope in the transfer pricing area that the work on intangibles will achieve at least a milestone, yet, as elaborated above and below in the context of the third insight, the utility of this outcome is in doubt. Everything else seems to rely on soft law, best practice deliverables at best. As elaborated throughout the article, this reliance conflicts with the plausible insights of the BEPS project. There are of course many issues for which treatment by the project is difficult to predict, and that fact alone raises concern, especially taking into account the short time frame.

Naturally, the same analysis also must be pessimistic about the compatibility of the OECD's work with the second insight. The OECD often mentions, albeit in a very inconsistent manner, the need to coordinate the work on the various action items, yet it has not yet developed a method or any principles for that coordination. Perhaps more important, the framework or forum for international tax policy coordination has not yet been discussed. Deferring this to Action Item 15 impairs the chances of collaboration to succeed. The apparent primary choice of method by the OECD – the publication of best practices to be implemented by domestic laws – is again in a principled conflict with the desire for a comprehensive and holistic approach. One surprising area of hope in this context may be in regard to transfer pricing. Regardless of this article's disagreement with the OECD, for transfer pricing, the OECD has (unprecedently) produced what sounds like a principle: allocation of tax base according to value creation. Further, it finally opened the door to a possibility of going "beyond arm's length", which, if taken seriously may be the most important achievement of the project. Of course, the implementation will be hard, yet this is progress in comparison with the aimless, arm's length based system existing today.

Unfortunately, transfer pricing may also be viewed as the most discouraging part of the project, at least from the perspective of the third insight of the BEPS project. The OECD seems to proceed with its rhetorical resistance to innovation and formulary solutions. Indeed, this may only be the rhetoric, and an enhanced profit split, perhaps together with safe harbours and predetermined margins, may find its way to the arsenal of permitted methods, yet it is the duty of academe and this article to emphasize the importance of genuine attention to this insight. Similarly, nothing has come out in the context of Action Item 1 in regard to the digital economy. One would hope for at least a clear statement of acknowledgment that such economy presents new, not similar, challenges to the international tax regime, in the same way that intangibles require a different, not analogous (to regulation of other property) tax treatment due to their unique characteristics.

Finally, the OECD should realize that the rules of the game have changed and the international tax regime (and with it, the OECD's power in the tax world) is at risk with all its very positive contributions. Legitimacy and universal public confidence are therefore key to the preservation of the regime. Transparency is desirable, but not transparency just in the form of more exchange of information (itself a worthy cause driven by the Global Forum), but also through openness to public, academic, and media analysis and through working toward making data available not only to tax authorities, through CBC reporting or any other manner. Accountability mechanisms are also an excellent idea in the right direction, but only if they are actually implemented.