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The Case Against BEPS: Lessons for Tax Coordination

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The Case Against BEPS: Lessons for Tax Coordination

by

*Mindy Herzfeld**

Abstract

In 2013, the Organisation for Economic Co-operation and Development (OECD), at the behest of the G20, embarked upon an ambitious project of coordinating and harmonizing countries' international tax rules under the guise of curtailing multinational companies' cross-border tax planning, generally referred to as base erosion and profit shifting, or BEPS. The project was finalized with great fanfare in November 2015. But the proclamations of success masked real underlying differences between participant countries. I argue that the project suffered from a number of flaws that largely precluded effective coordination, as a result of which the project's recommendations largely gloss over key differences in participants' goals and commitments while doing nothing to solve the systemic problems it was seeking to address. For example, while a key stated goal of the project was to align the taxation of profits with value creation, there was no attempt made to define the location of value creation nor to address the fact that this principle is fundamentally at odds with the arm's length principle that serves as the backbone of transfer pricing rules.

The project left in its wake a system even more broken than before, but one papered over with rhetoric suggesting the illusion of

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consensus and general agreement on new rules. Broadly worded anti-abuse rules allow different countries to go in their own, preferred directions in interpretation, implementation, and enforcement. They thus open the door to unprincipled and aggressive tax agents and an increase in multilateral tax disputes, with no clearer path to resolution. Poor outcomes were largely predictable from the project's premises, which merely sought to reinforce the existing rules but never questioned whether those rules needed updating to adjust for global economic changes to lead to a fairer allocation of taxing rights. Furthermore, the project failed to acknowledge the bias in the existing system, which meant that the outcomes were likely to benefit more powerful countries at the expense of smaller and weaker ones. While the project may have succeeded in its overt goal of limiting multinationals' international tax avoidance, it never addressed the more systemic failures of the system that underpinned the broad consensus it achieved in obtaining initial agreement on its action plan.

The BEPS project thus holds important lessons for the future of international coordination efforts, as efforts to fix a broken international tax system, restore public confidence in multinational corporations, and achieve real agreement on the underlying principles of the rules must continue, if only to minimize the flood of disputes expected to result from the recent changes in law and policy.

Introduction 3
I. BEPS in Perspective 8
  A. What Is BEPS? 8
  B. Origin of Current System 13
    1. Colonialism and the Development of International Tax Rules 13
    2. A More Benign View 17
  C. Why BEPS Now? 18
    1. Inequity and the Financial Crisis 18
    2. Digital Economy 21
    3. Cover for Politicians 22
    4. Global Power Shifts 23
    5. The OECD's Role 28
II. Weak Foundations 29
  A. Global Politics 29
    1. No Agreement on Allocation 29
    2. Global Politics—Shifts in Balance of Power 35

B. Domestic Politics 37
1. Power to Tax Means Political Power 37
2. The Need to Encourage Investment (E.g., Patent Box) 38
C. Value Creation 42
III. Poor Outcomes 43
A. Minimum Standards and Lack Thereof 43
B. U.S. Nonparticipation 45
C. Digital Economy 50
D. Vague Rules 52
1. Transfer Pricing Guidelines—Deliberate Incoherence? 52
2. The Permanent Establishment Standard 56
IV. Conclusion 59

Introduction

International tax rules have a number of goals. They allocate taxing rights between two jurisdictions when goods or services are transferred across borders. They set out guiding principles for when a resident of one country may be taxed by another country on income associated with that country. They may encourage or discourage cross-border trade based on the degree to which countries attempt to assess tax on cross-border transactions, such as the extent to which countries give relief for taxes paid in another jurisdiction. Finally, they aim to protect individual countries' tax bases by preventing taxable income from escaping national borders.[1]

The rules accomplish these goals through a number of mechanisms. Countries can set their own domestic laws governing cross-border transactions or their residents' foreign earnings. Withholding taxes allow countries to assess taxes earned by foreign residents from cross-border sources. Bilateral tax treaties set out agreements between two countries over how to allocate taxing rights for income that could be taxed in one or the other jurisdiction in order to prevent double taxation. Multilateral agreements such as model treaties or transfer

1. *See generally* Hugh J. Ault et al., Comparative Income Taxation: A Structural Analysis (3d ed. rev. 2010).

pricing guidelines represent commitments from a larger group of countries to a more widely accepted set of principles.

The international tax laws and agreements in existence today are, with few major modifications, built upon rules that were put in place in the early twentieth century.[2] The belief that they no longer function well in today's global and digital age is widespread.[3] In the United States, cries for the need to update domestic international tax rules to reflect a different global financial and political order have been getting progressively louder over the past several decades. More recently, this need has been recognized on a global scale.[4] Macro-economic developments, growth in cross-border trade, shifts in global political power, and the increasing sophistication of the world's financial system, have all put increasing pressure on the rules and how they are enforced. At the same time, individual countries' incentives to change their rules to protect their own corporate tax bases are under pressure due to fears over the loss of investment that could result from a tax system being viewed as uncompetitive in a world of mobile capital.

The global financial crisis of the late 2000s provided both an incentive and a means of addressing these concerns. With employment and social services suffering and government budgets under strain, the ability to attract more revenues from corporations presented itself as a useful fix to some of society's most highly visible problems. Countries could avoid the beggar-thyself problem by acting in a coordinated fashion. Corporate tax planning, facilitated by global accounting firms, served as a useful point of attack for pursuing the goal of shoring up domestic revenues. Multinational companies, whose own ties to any particular country were exceedingly attenuated as revenue sources and manufacturing locations shifted from historical locales, provided

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2. *See* Michael J. Graetz & Michael M. O'Hear, *The "Original Intent" of U.S. International Taxation*, 46 Duke L.J. 1021, 1022–24 (1997).

3. *See, e.g.*, Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State*, 113 Harv. L. Rev. 1573 (2000); Michael J. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 Tax L. Rev. 261 (2001) (David R. Tillinghast Lecture); Edward D. Kleinbard, *Stateless Income*, 11 Fla. Tax Rev. 699 (2011) [hereinafter Kleinbard, *Stateless Income*]; Edward D. Kleinbard, *The Lessons of Stateless Income*, 65 Tax L. Rev. 99 (2011) [hereinafter Kleinbard, *Lessons*].

4. *See* Yariv Brauner, *What the BEPS?*, 16 Fla. Tax Rev. 55, 56–58 (2014).

a particularly promising scapegoat for attacks rooted in fears of economic decline and inequality.[5]

Out of this environment was born the base erosion and profit shifting project, or BEPS, mandated by the G20, and managed and implemented by the Organisation for Economic Co-operation and Development (OECD).[6] Under the guise of cracking down on multinationals' tax planning techniques that enabled them to lower their global tax burdens, in part by moving their profit-generating assets and activities to low-tax jurisdictions, the project was intended to facilitate the coordination of international tax rules to ensure higher effective corporate tax rates (an objective implicit but never directly stated in the project's action plan). The coordinated nature of the project was key to making sure that rogue countries did not attract additional corporate investment at the expense of other countries looking to plug the leaks in their own domestic revenue bases.[7]

Over the course of two years, the OECD pushed through reports, recommendations, and changes in 15 identified areas of international tax rules.[8] But the volume of paper published by the OECD glosses over its poor results. Claims of success in the BEPS project pay lip service to agreements on paper but mask real underlying differences that will cause significant problems going forward. In the area of transfer pricing rules, for example, the OECD introduced a set of rules that lacks the economic

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5. *See, e.g.*, Tom Bergin, *Special Report: How Starbucks Avoids UK Taxes*, Reuters (Oct. 15, 2012), http://www.reuters.com/article/us-britain-starbucks-tax-idUSBRE89E0EX20121015; Charles Duhigg & David Kocieniewski, *How Apple Sidesteps Billions in Taxes*, N.Y. Times (Apr 28, 2012), http://www.nytimes.com/2012/04/29/business/apples-tax-strategy-aims-at-low-tax-states-and-nations.html?action=click&contentCollection=Business%20Day&module=RelatedCoverage®ion=EndOfArticle&pgtype=article; *Firms' Secret Tax Avoidance Schemes Cost UK Billions*, Guardian (Feb. 1, 2009), https://www.theguardian.com/business/2009/feb/02/tax-gap-avoidance.

6. *See* Press Release, OECD, Closing Tax Gaps–OECD launches Action Plan on Base Erosion and Profit Shifting (Jul. 19, 2013), http://www.oecd.org/ctp/beps/closing-tax-gaps-oecd-launches-action-plan-on-base-erosion-and-profit-shifting.htm.

7. OECD, *Action Plan on Base Erosion and Profit Shifting* (2013), http://dx.doi.org/10.1787/9789264202719-en [hereinafter *BEPS Action Plan*].

8. *See* Stephanie Soong Johnston, *OECD Releases Final BEPS Package*, 149 Tax Notes 177 (Oct. 12, 2015).

coherence necessary to produce the meaningful analysis needed to support cross-border pricing. On the crucial area of determination of when a resident of one country has a permanent establishment (PE) in another country, perhaps the fundamental basis for determining the allocation of taxing rights among countries, the project produced a vaguely worded standard with little interpretive guidance. The rules for how to allocate profits to newly found PEs remain unresolved. In the area of treaty abuse, a broadly worded anti-abuse test, the adoption of which is essentially a requirement for all countries signing up to the project, will serve as the basis for litigation and uncertainty for many years to come. Rather than coordinated rules, the project resulted in vague standards that everyone could agree on because they meant all things to all people.

Most importantly, the project failed in one of its most crucial tasks: to force the United States to change its rules to prevent its multinationals from engaging in income-shifting activities among other countries. Not only did the United States not change its rules to benefit other countries, discussions of U.S. tax reform under a new administration opened up the possibility of even more radical tax reforms that potentially benefit U.S. companies to the detriment of other countries. Finally, the project resulted in no meaningful consensus for improvement on the mechanism for resolution of cross-border disputes.

The BEPS project may be able to declare success in one of its declared aims: that of ensuring greater tax payments by multinational companies (only time will tell). But proclaiming success for a project that weakens an already fragile international tax system is to no one's benefit, other than those who hope for collapse in order to start from scratch.[9] Vague guidelines that don't lend themselves to clear interpretation and application don't necessarily benefit tax authorities in the long run.[10]

The poor outcomes of the BEPS project could largely have been predicted because of the nature of the project's undertaking and its underlying premises. Amidst the rhetoric and the declared focus on stopping multinationals' tax avoidance activities, the opportunity for a rigorous examination of the underlying causes of the identified issues was missed. Also hidden behind the rhetoric was any meaningful discussion

9. *See generally* Mindy Herzfeld, *The Year in Review: Whither the International Tax System?*, 85 Tax Notes Int'l 22 (Jan. 2, 2017).

10. *See* Alex Raskolnikov, *Probabilistic Compliance*, 34 Yale J. on Reg. 491, 498–500 (2017).

of real and significant concerns going to the merit and validity of the endeavor. There was no acknowledgement of the various reasons why local politicians offer tax incentives or other (less explicit) tax planning opportunities to multinationals, or of the role played by governments in facilitating tax planning opportunities for both domestic and foreign companies. Tensions between emerging economies and OECD member countries, which lay (unacknowledged) at the root of the project, remained unaddressed.

The project also failed to address another set of broader, more philosophical questions, rooted in economics but also in concerns over fairness in the context of global economic development. The tools that public finance economists have developed for analyzing what constitutes sound policy in a domestic setting are not easily transportable when the questions morph from those having to do with maximizing economic welfare within a particular set of borders to maximizing welfare globally. No country has signed on to such a concept as the basis for international tax rules that may lead to the diminishing of its own revenue intake.[11] In a coordination setting, larger countries can and likely will act to negotiate and implement rules that may work to their best advantage, potentially to the disadvantage of smaller and less powerful countries, and the BEPS project largely failed to assuage such concerns.[12]

These concerns provide lessons for international tax coordination efforts more broadly and prompt the question as to whether there are alternative mechanisms for improving the existing system. Greater scrutiny of the systemic issues that prompted the BEPS project, rather than a narrow focus on corporate tax avoidance, could have resulted in a more substantive project, rather than the flawed endeavor that BEPS became.

This Article proceeds as follows. Part I provides a background on the BEPS project. It begins with a brief outline of the project and then steps back in time to review the historical framework of international tax rules, followed by an analysis of the immediate factors giving rise to the project. Part II explores the issues that underlay and proved problematic for successful outcomes of the BEPS project and that pose challenges for future international coordination efforts as well.

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11. *See* Graetz, *supra* note 3, 277–82.

12. *See generally* Tsilly Dagan, International Tax Policy: Between Competition and Cooperation (forthcoming 2018).

Part III describes how the underlying issues resulted in poor outcomes in the BEPS project. Part IV concludes.

I. BEPS in Perspective

A. What Is BEPS?

In 2012, the G20 tasked the OECD with developing an action plan to combat base erosion and profit shifting by multinational enterprises.[13] The G20's mandate to the OECD was to fix aspects of the current international tax system that were facilitating base erosion and profit shifting by multinationals.[14] The OECD was supposed to prevent large amounts of multinationals' corporate profits from not being subject to tax in any jurisdiction, often referred to as "double non-taxation" or "stateless income."[15]

The OECD responded by publishing a 15-point action plan (BEPS Action Plan) in June 2013.[16] To some critics, the BEPS Action

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13. G20 Leaders' Declaration, Los Cabos, Mexico, ¶ 48 (Jun. 18–19, 2012), http://www.consilium.europa.eu/uedocs/cms_Data/docs/pressdata/en/ec/131069.pdf ("We reiterate the need to prevent base erosion and profit shifting and we will follow with attention the ongoing work of the OECD in this area."). The G20, an informal group of the largest economies, is an outgrowth of the G7 that has become more active in the years since the 2008 financial crisis. The BEPS project represents the G20's first foray into directing substantive international tax policy. Itai Grinberg, *The New International Tax Diplomacy*, 104 Geo. L.J. 1137, 1146–52 (2016) (describing the transition of the G20 from a role as setting financial regulatory policy into the international tax policy arena). As Grinberg notes, although the G20 operates under no administrative rulebook, and without any entrenched bureaucracy, its power and influence over international financial regulation has increased markedly over the past few years. *See id.*

14. Involvement of the G20 in international tax affairs has increased the politicians' engagement in global tax policy. *See* Grinberg, *supra* note 13; Mindy Herzfeld, *News Analysis: Why BEPS Is Just the Beginning*, 79 Tax Notes Int'l 983, 985–86 (Sept. 21, 2015).

15. *See, e.g.*, Brauner, *supra* note 4, at 79; Kleinbard, *Stateless Income*, *supra* note 3, at 700.

16. *BEPS Action Plan*, *supra* note 7; OECD, *Developing a Multilateral Instrument to Modify Bilateral Tax Treaties: Action 15: 2015 Final*

Plan represented far more than a targeted attack on specific abusive practices involved in profit shifting and suggested that the OECD would be undertaking a re-examination of many of the fundamental building blocks of the international tax regime.[17] To others, however, the BEPS Action Plan failed to go far enough, because it claimed adherence to the core principles of the international tax system. Those who advocated a wholesale revamp of the international tax rules to accommodate a more globally connected economy were disappointed.[18]

In the 15 BEPS action items, the OECD addressed a wide range of topics. These can be grouped into several broad categories: recommended actions for changes in domestic laws; revisions to treaties; modifications to the OECD transfer pricing guidelines; and transparency

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Report, ¶ 3 (2015), http://dx.doi.org/10.1787/9789264241688-en [hereinafter *Action 15 Report*].

17. *See, e.g.*, Reuven S. Avi-Yonah & Haiyan Xu, *Evaluating BEPS: A Reconsideration of The Benefits Principle and Proposal for UN Oversight*, 10 Erasmus L. Rev. 3, 6 (2017) ("The primary problem with the BEPS project is that . . . new principles and new rules have not been truly established for the new direction, and the old principles have been strengthened by a patch up of current rules"); Swapneshwar Goutam, *Critical Account of the OECD's Action Plan on Base Erosion and Profit Shifting*, 8 Madras L.J. 9, Vol. 287 (2014), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2544466 (questioning whether the action plan will go far enough from a developing country perspective). For example, in Action 7, the OECD undertook to review the PE rules, stating that it would "[d]evelop changes to the definition of PE to prevent the artificial avoidance of PE status in relation to BEPS." *BEPS Action Plan*, *supra* note 7, at 19. Through Action 6, the OECD would be looking to "[d]evelop model treaty provisions and recommendations regarding the design of domestic rules to prevent the granting of treaty benefits in inappropriate circumstances." *Id.; see also Explanation and Analysis of the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting (MC-BEPS)*, BEPS Monitoring Group (Apr. 24, 2017), https://bepsmonitoringgroup.files.wordpress.com/2017/03/explanation-and-analysis-of-mc-beps.pdf.

18. *See* Kristen A. Parillo et al., *OECD BEPS Action Plan Draws Praise, Criticism*, 140 Tax Notes 437, 437–38 (July 29, 2013); Sol Picciotto, *Can the OECD Mend the International Tax System?*, 71 Tax Notes Int'l 1105, 1114 (Sept. 16, 2013) (describing the project as having "much more radical aims: to remodel the international tax system to ensure that [transnational corporations] are taxed according to where they actually do business").

and exchange of information initiatives. Also included in the BEPS Action Plan were a number of studies and reports relevant to the overall project but not recommending particular rule changes.[19] Changes to the OECD model treaty are one of the most important parts of the project and are addressed in a number of action items. Action 6, for example, includes language to ensure that treaties are not used to facilitate treaty abuse and double non-taxation.[20] Action 7 provides revised language for the model treaty standard for a PE.[21] The BEPS Action Plan also included a proposal for a multilateral instrument that would incorporate proposed changes to the model treaty into bilateral treaties in a single stroke.[22]

Actions 8 through 10 include revisions to the OECD transfer pricing guidelines.[23] These rules govern how related parties price goods and services in cross-border transactions. Many OECD member countries, as well as a number of non-OECD members, have incorporated these guidelines into domestic law. Changes to the guidelines thus have immediate effect. Indeed, anecdotal evidence suggests that many tax administrations are already applying the new principles on audit.

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19. The OECD has generally described the work included in the BEPS project as falling into three categories, namely (1) transparency efforts to improve tax administrations' knowledge of multinationals' structures and taxable profits; (2) substantive efforts to align tax with economic substance and value creation; and (3) coherence or coordination of international tax rules to avoid tax arbitrage. According to its schema, each of the 15 action items fits within one of these categories. *See, e.g.*, OECD, *Taxing Multinational Enterprises: BEPS Update No. 3*, Policy Brief, Oct. 2015, http://www.oecd.org/ctp/policy-brief-beps-2015.pdf.

20. OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances: Action 6: 2015 Final Report*, at 9–11 (2015), http://dx.doi.org/10.1787/9789264241695-en.

21. OECD, *Preventing the Artificial Avoidance of Permanent Establishment Status: Action 7: 2015 Final Report*, at 9 (2015), http://dx.doi.org/10.1787/9789264241220-en [hereinafter *Action 7 Report*].

22. *See Action 15 Report*, *supra* note 16, at 9–10; OECD, *Action 15: A Mandate for the Development of a Multilateral Instrument on Tax Treaty Measures to Tackle BEPS* (2015), http://www.oecd.org/ctp/beps-action-15-mandate-for-development-of-multilateral-instrument.pdf.

23. OECD, *Aligning Transfer Pricing Outcomes with Value Creation: Actions 8–10: 2015 Final Reports* (2015), http://dx.doi.org/10.1787/9789264241244-en [hereinafter *BEPS Transfer Pricing Report*].

One aspect of BEPS that has seen widespread take-up is the new transfer pricing documentation requirements—the country-by-country report—included in Action 13. This is the one area in which the United States has taken action on BEPS to date.

Action 13 is referred to as a "minimum standard" by the OECD. Other "minimum standards" include transparency initiatives under Action 5, which appears as a reincarnation of an earlier OECD project. What started out in the 1990s as an attempt to shut down harmful tax regimes has through the BEPS project morphed into something else altogether. In its review of harmful tax practices, Action 5 started with patent boxes and, in the process, developed guidelines for when patent boxes should be considered not harmful (having met substantial nexus requirements). Also contained in Action 5 are recommendations for automatic exchange of cross-border tax rulings.[24]

Even in areas where the BEPS reports include consensus-based recommendations, not all participating countries are fully on board. For example, Action 2 contains recommendations on hybrid instruments, while Action 4 has recommendations for interest expense limitations. Both action items attempt to address excessive interest expense deductions in the cross-border context. While some countries have evidenced an intention to incorporate the BEPS recommendations legislatively, others such as the United States may not move quickly, if at all, in this area.[25]

Not all the BEPS reports prescribe recommended law changes. Due to lack of agreement among participants, a number of the reports simply take the form of analyses or recitation of best practices. The

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24. OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance: Action 5: 2015 Final Report* (2015), http://dx.doi.org/10.1787/9789264241190-en [hereinafter *Action 5 Report*].

25. *See* Ryan Finley, *HM Treasury Issues Proposals to Modify U.K. Patent Box*, 2015 Worldwide Tax Daily 206–3 (Oct. 26, 2015); Ryan Finley, *U.K. Seeks Public Comment on BEPS Interest Deductibility Rules*, 2015 Worldwide Tax Daily 205-2 (Oct. 23, 2015); Mindy Herzfeld, *News Analysis: U.K. Leads on BEPS While the U.S. Dither*s, 80 Tax Notes Int'l 727 (Nov. 30, 2015); Mindy Herzfeld, *News Analysis: Will the United States Take Action on the BEPS Action Plan*?, 79 Tax Notes Int'l 817 (Sept. 7, 2015); Mindy Herzfeld, *The U.K. Embraces Tax Competition and BEPS*, 75 Tax Notes Int'l 85 (July 14, 2014); *see also* Council Directive 2016/1164, 2016 O.J. (L 193) 1 (EU).

digital economy report (Action 1) outlines a series of options countries could take to ensure better taxation on profits from digital transactions, while a report on controlled foreign corporations (Action 3) merely provides guidelines based on what different countries are doing as best practices. The report on mandatory disclosures (Action 12) describes different approaches to requiring taxpayers to disclose information about aggressive tax transactions to respective governments.[26]

A number of other items included in the BEPS Action Plan are of great interest to international tax practitioners, taxpayers, and tax administrations, but not immediately relevant to the task of limiting base erosion and profit shifting practices. These include Action 11, which tries to quantify revenues lost to governments from BEPS practices and develop a methodology for monitoring the effectiveness of BEPS recommendations, and Action 14, intended to improve multilateral dispute resolution procedures. Like Actions 5, 6, and 13, commitments to improved dispute resolution procedures is a BEPS minimum standard.

The OECD surprised most tax professionals and political observers by meeting its timelines and producing reports on each of the action items within the prescribed two-year timeline. It released a package of final BEPS reports in October 2015. The OECD maintains that the coordination of international tax rules reflects a new global consensus that will result in a crackdown on tax havens and curb abuses in international tax arbitrage.[27]

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26. Nevertheless, some countries have acted on these reports. For example, India has enacted an equalization tax reviewed but not recommended in the Action 1 report (see discussion *infra* III.C, and the European Commission has published a draft directive on mandatory disclosure rules). *See Proposal for a Council Directive Amending Directive 2011/16/EU as Regards Mandatory Automatic Exchange of Information in the Field of Taxation in Relation to Reportable Cross-Border Arrangements*, COM (2017) 335 final (Jun. 21, 2017).

27. *See* OECD*, Explanatory Statement: 2015 Final Reports*, at 5 (2015), https://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf ("Once the [BEPS] measures are implemented, many schemes facilitating double non-taxation will be curtailed" because the "implementation of the BEPS package will better align the location of taxable profits with the location of economic activities and value creation, and improve the information available to tax authorities to apply their tax laws effectively.").

B. Origin of Current System

1. Colonialism and the Development of International Tax Rules

The current international tax system has its roots in the years before and after World War I.[28] The rules hashed out in the early twentieth century by European nations and the United States set the parameters for a system which mostly remained in place for the next century. Key to the development of the current system was agreement on a model bilateral tax treaty.[29] The terms of that treaty, which currently exists in the form of the OECD model treaty, has since served as the basis for the negotiation and terms of thousands of bilateral tax treaties.[30] All OECD member countries have bilateral tax treaties in place that, in their format, generally follow the original 1928 model treaty developed by the League of Nations.[31] The OECD model treaty is regularly updated along with its extensive commentary. The OECD's role with regard to the model treaty has allowed the OECD to play a key position in the development and ongoing modification of international tax rules. Through its Committee of Fiscal Affairs, the OECD has played a significant function in coordinating international tax policy among its members and in setting the rules under which cross-border trade is taxed globally.

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28. *See* Graetz, *supra* note 3, at 262–63 ("[N]ot only the fundamental structure of the system for taxing international income today, but also many of the core concepts used to implement that structure—concepts such as PE, corporate residence, and arm's length pricing—date from a time when airplanes were first becoming a regular means of travel, and when the 'wireless' was a relatively new instrument of communication . . . .").

29. *See* Graetz & O'Hear, *supra* note 2, at 1023 ("[T]he fundamental structure for international taxation of income announced nearly seven decades ago in the 1928 League of Nations Model Treaty forms the common basis for more than twelve hundred bilateral tax treaties now in force throughout the world.").

30. On the development of tax treaties, see generally Klaus Vogel, *Double Tax Treaties and Their Interpretation*, 4 Int'l Tax & Bus. Law. 1 (1986). *See also* Wei Cui, *Minimalism About Residence and Source*, 38 Mich. J. Int'l L. 145, 265 (2017) ("Both critics and defenders of the current international tax regime trace the 'traditional principles' of international taxation to a small group of elite academics and policymakers working for the League of Nations in the 1920s and 1930s.").

31. Graetz & O'Hear, *supra* note 2, at 1023.

Bilateral tax treaties govern the taxation of cross-border transactions by allocating taxing rights among and between its signatory countries.[32] The rules operate by first categorizing and classifying items of income into different categories. The treaty then assigns primary rights to tax different categories of income to one or the other of the treaty partners.[33] In general, treaties divide up taxing rights between source countries (the country where the business operations take place) and residence countries (the country where the owner or investor is tax resident). The current allocation of taxing rights is generally considered to favor residence countries at the expense of source countries (although this issue is a matter of some dispute).[34] Treaties also provide a set of rules for determining when a person's activity in another jurisdiction (in which it is a non-resident) may be subject to tax by that jurisdiction. Generally speaking, activity must give rise to a PE in another jurisdiction in order to be taxed there. The PE threshold sets a bar for source countries to overcome before being able to assert taxing rights.[35]

Some argue that the rules developed in the aftermath of World War I for the allocation of taxing rights favored rich capital exporting countries at the expense of poorer nations, former colonies in particular. This narrative assumes that the countries that negotiated the principles of tax treaties were acting primarily in their own self-interest.[36]

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32. *See* David S. Foster, *The Importance of Tax Treaties*, 5 Hastings Int'l & Comp. L. Rev. 565, 566 (1982); Dan Throop Smith, *The Functions of Tax Treaties*, 12 Nat'l Tax. J. 317, 317–18 (1959).

33. *See* Cui, *supra* note 30, at 265.

34. *See* Veronika Daurer, *Tax Treaties and Developing Countries*, 42 Intertax 695, 696 (2014); Bret Wells & Cym H. Lowell, *Income Tax Treaty Policy in the 21st Century: Residence Vs. Source*, 5 Colum. J. Tax L. 1, 30 (2013) ("[T]he 1935 Revised Draft Model Treaty shifted the balance of power away from source countries and toward the country of residence."). *See generally* Graetz & O'Hear, *supra* note 2; Michael Lang & Jeffrey P. Owens, *The Role of Tax Treaties in Facilitating Development and Protecting the Tax Base* (WU [Vienna Univ. of Econ. & Business] Int'l Tax'n Research Paper Series, Paper No. 2014-03, 2014), http://papers.ssrn.com/sol3/papers.cfm?abstract_id=2398438.

35. *See* Richard J. Vann, *International Aspects of Income Tax*, *in* Tax Law Design and Drafting 718, 762–64 (Victor Thuronyi ed., vols. 1–2, 2000).

36. For example, Lowell and Wells argue that the organizing principles of the original model treaty policies involved "base erod[ing] colony

Under this narrative, the countries that developed the international tax rules that were then accepted by the rest of the world did so at others' expense. This perspective, still very much in evidence at meetings of the United Nations (U.N.) tax committee today,[37] assumes that much of the developing world was disadvantaged by the treaty rules laid out in the formative tax treaties. This account gives credence to and emphasizes the importance of the U.N. tax committee, which is supposed to act as a counterweight to the OECD and the international tax policy interests of its member countries.[38] The U.N. tax committee has developed its own version of a model treaty, the provisions of which are generally considered more favorable to developing countries, because they provide for greater taxing rights for source countries.[39]

The principle that tax treaties are needed to alleviate double taxation is embedded in the development of the bilateral treaty network.[40]

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countries for the benefit of imperial countries. . . ." Wells & Lowell, *supra* note 34, at 21. They posit that the 1920s framework "was based on the mercantilist belief that imperial countries" were crucial providers "of capital and know-how while the colonies were passive suppliers of goods or services with little value added functionality." *Id.* at 10. "As a result, the right to tax residual income belonged to the residence countries of the imperial companies. . . ." *Id.* Source countries were allocated only routine profits. *Id.* at 10–11.

37. See discussion *infra* I.C.4 & II.A.2.

38. The U.N. committee of experts lacks the status of an intergovernmental agency, and it has a skeletal budget with only a few employees. Mindy Herzfeld, *News Analysis: Implementing BEPS (or Not) in the Developing World*, 80 Tax Notes Int'l 475 (Nov. 9, 2015); Mindy Herzfeld, *News Analysis: The U.N. Rewrites International Tax Rules*, 76 Tax Notes Int'l 477 (Nov. 10, 2014).

39. The U.N. also has a transfer pricing manual to assist developing countries in applying transfer pricing rules. *See* Dep't of Econ. & Soc. Affairs, U.N. Practical Manual on Transfer Pricing for Developing Countries, U.N. Doc. ST/ESA/ (2d ed. 2017), http://www.un.org/esa/ffd/wp-content/uploads/2017/04/Manual-TP-2017.pdf.

40. The commentary to the introduction to the OECD model treaty states, "The principal purpose of double taxation conventions is to promote, by eliminating international double taxation, exchanges of goods and services, and the movement of capital and persons." OECD Model Tax Convention on Income and on Capital, July 15, 2014, art. 1, cmt. 7; *see also* Alex Trepelkov, *Preface to* The United Nations Handbook on Selected Issues in Administration of Double Tax Treaties for Developing Countries iii, iii (Alexander Trepelkov et al. eds., 2013) (noting the important role played by tax treaties in "encourag[ing] international investment and, consequently, global economic

But over the past decades, academic commentators have adopted a more critical perspective. Tsilly Dagan of Bar Ilan University argues that treaties are not necessarily needed to reach the goal of alleviating double taxation because they "often just replicate the mechanism that countries unilaterally use to alleviate double taxation."[41] Instead, she argues that they "serve much less heroic goals, such as easing bureaucratic hassles and coordinating tax terms between the contracting countries, and much more cynical goals, particularly redistributing tax revenues from the poorer to the richer signatory countries."[42] According to Dagan, the current international tax system results in a shift of taxable revenues from poorer to richer countries.[43] This view receives support in recent papers by international organizations such as the International Monetary Fund (IMF), which notes that "the network of bilateral double taxation treaties based on the OECD model significantly constrain[s] the source country's rights."[44] As a result, the IMF has suggested that developing

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growth, by reducing or eliminating international double taxation over cross-border income"); Brian Arnold, *An Introduction to Tax Treaties*, United Nations 5–6, http://www.un.org/esa/ffd////wp-content/uploads/2015/10/TT_Introduction_Eng.pdf (last visited Sept. 24, 2017) (noting that the wide acceptance of the U.N. and OECD model conventions has been important in reducing double taxation).

41. Tsilly Dagan, *The Tax Treaties Myth*, 32 NYU J. Int'l L. & Pol. 939, 941 (2000); *see also* Elisabeth Owens, *United States Income Tax Treaties: Their Role in Relieving Double Taxation*, 17 Rutgers L. Rev. 428 (1963); Julie Roin, *Rethinking Tax Treaties in a Strategic World with Disparate Tax Systems*, 81 Va. L. Rev. 1753 (1995).

42. Dagan, *supra* note 41, at 939. Dagan argues that because "treaties have generally been constructed by and for developed countries with mutual interests and ideology" (*id.* at 990), they "provide residence countries with a larger slice of the revenue pie than do the unilateral mechanisms." *Id.* at 982. Similarly, Lowell and Wells claim that "the existing model treaties, and the original [transfer pricing] rules to implement those treaties, were purposefully skewed" in favor of richer imperial nations. Wells & Lowell, *supra* note 34, at 34.

43. *See* Dagan, *supra* note 41, at 982 ("[T]reaties tend to limit the tax rate a host country can impose on passive income . . . . Except in cases where tax sparing is granted, such a reduction in host country taxation does not translate into a larger volume of foreign investment, but rather amounts to no more than a revenue shift."); *see also* Wells & Lowell, *supra* note 34, at 34.

44. IMF, *Spillovers in International Corporate Taxation*, Policy Paper 12 (May 9, 2014) (footnote omitted), https://www.imf.org/external/np/pp/eng/2014/050914.pdf.

countries "would be well-advised to sign treaties only with considerable caution."[45]

2. A More Benign View

An alternative version of this history exists, which instead of emphasizing how the foundations of the current international tax system rest on an imperialist worldview, describe a more nuanced picture based on the history of the enactment of the U.S. foreign tax credit. Enactment of this credit means that the United States gives primary taxing rights to the source country rather than to the residence (investor) country. Graetz and O'Hear have characterized enactment of the foreign tax credit by the United States as an example of a country acting in a selfless manner[46] and as "an extraordinarily generous measure for its time."[47] Its enactment meant that the United States assumed "sole responsibility for the costs of reducing the double taxation of its residents and citizens."[48]

In making this argument, Graetz and O'Hear are not trying to claim that U.S. international tax policy has been driven primarily by altruism; they point out that the credit was viewed "as a method to encourage foreign trade and to prevent revenue loss."[49] The fact that the United States was the world's creditor after World War I also may have motivated it to develop international tax rules that favored "generosity in source rules to capital importers."[50]

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45. *Id.* at 24; *see also* IMF, *Options for Low Income Countries' Effective and Efficient Use of Tax Incentives for Investment*, A Report to the G-20 Development Working Group by the IMF, OECD, UN and World Bank (Oct. 2015), https://www.imf.org/external/np/g20/pdf/101515.pdf [hereinafter *IMF Incentives Report*]; Mindy Herzfeld, *News Analysis: The Backlash Against Tax Treaties and Free Trade*, 84 Tax Notes Int'l 438, 438 (Oct. 31, 2016).

46. Graetz & O'Hear, *supra* note 2, at 1040, 1059 (arguing that the foreign tax credit was "a rejection of the primacy of residence based taxation," and that it "effectively gave priority to source-based taxation, while retaining residence-based taxation as a backstop").

47. *Id.* at 1045.

48. *Id.* Graetz and O'Hear note that "[s]uch generosity was virtually unprecedented." *Id.* at 1046.

49. *Id.* at 1047, n.106 (quoting Roswell Magill & William C. Schaab, *American Taxation of Income Earned Abroad*, 13 Tax L. Rev. 115, 118 [1958]).

50. Graetz & O'Hear, *supra* note 2, at 1072.

C. Why BEPS Now?

Calls for a revamp of the international tax system are not new. Scholars, policy makers, practitioners, and taxpayers have for several decades been referring to the system as broken.[51] Yet it was not until directed by the G20 to address the issues of base erosion and profit shifting that the OECD began to seriously undertake a major effort of reform. As with any significant policy change, the impetus for the BEPS project was a confluence of factors, outlined below.

1. Inequity and the Financial Crisis

The international tax system muddled along in its basic form throughout most of the twentieth century but was increasingly being called into question by the 1990s.[52] But little was done until the immediate aftermath of the financial crisis of 2008, as a direct result of which many governments undertook austerity programs.[53] The public discontent with crackdowns in social welfare spending also prompted nongovernmental organizations (NGOs) and the press to question why many corporations reported effective tax rates far below statutory rates. The fact that multinationals' corporate tax payments in a given country rarely matched, and often were significantly less than, statutory corporate income tax rates was an easy target for claims of inequity. Corporate international tax planning became headline news as never before.[54] The BEPS project

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51. *See* Graetz, *supra* note 3, at 269 (noting in 2000 that it was "a propitious time for a fundamental reexamination of the system of international income taxation and the principles and concepts on which it is based" due to changes in the world economy including advances in trade, increased global capital flows, and more sophisticated financial products); *see also* Avi-Yonah, *supra* note 3, 1575–79.

52. *See* Graetz, *supra* note 3.

53. *See* Brauner, *supra* note 4, at 64.

54. *See, e.g.*, Bonnie Kavoussi, *Google Avoids $2 Billion in Taxes by Offshoring Profits in Bermuda*, Huffington Post (Dec. 10, 2012), http://www.huffingtonpost.com/2012/12/10/google-taxes-bermuda_n_2270354.html; Renai LeMay, *Australian Govt Pledges Action on Google Tax Avoidance*, Delimiter (Nov. 23, 2012), https://delimiter.com.au/2012/11/23/australian-govt-pledges-action-on-google-tax-avoidance/; Lisa O'Carroll, *If Google Is in Ireland for Tax Reasons, Why Are Most of Its Profits in Bermuda?*, Guardian (Mar. 24, 2011), https://www.theguardian.com/business/ireland-business-blog-with-lisa

was fueled by public perceptions of lack of fairness,[55] a perception evident overseas much more than in the United States.[56]

In official OECD documents, notions of fairness and equity dominate as rationales for the BEPS project. For example, in presenting the BEPS Action Plan to the G20, OECD Secretary-General Angel Gurría noted, "The joint challenges of tax evasion and tax base erosion lie at the heart of the social contract."[57] Similarly, in its statement endorsing the OECD's action plan, the G20 said, "In a context of severe fiscal

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-ocarroll/2011/mar/24/google-ireland-tax-reasons-bermuda; Nick Sommerlad, *Six Firms Including Google and Facebook Made £14BILLION Last Year but Paid Just 0.3% UK Tax,* Mirror (Jan. 31, 2015), http://www.mirror.co.uk/news/business/six-firms-including-google-facebook-5081824; *Starbucks: No UK Tax Paid Since 2009*, SkyNews (Oct. 16, 2012), http://news.sky.com/story/starbucks-no-uk-tax-paid-since-2009-10467070; Matt Warman, *Google's £6billion Bermuda Tax Shelter*, Telegraph (Jan. 2, 2013), http://www.telegraph.co.uk/technology/google/9775216/Googles-6billion-Bermuda-tax-shelter.html. A BBC News article noted how "a recent spate of stories has highlighted a number of tax-avoiding firms that are not seen to be playing their part." Vanessa Barford & Gerry Holt, *Google, Amazon, Starbucks: The Rise of "Tax Shaming*," BBC News Mag. (May 21, 2013), http://www.bbc.com/news/magazine-20560359.

55. *See* Brauner, *supra* note 4, at 57 ("[T]he substantive rules of the international tax regime were beside the point; it was the media exposure of these tax-planning schemes that mattered."); *see also* Andrew P. Morriss & Lotta Moberg, *Cartelizing Taxes: Understanding the OECD's Campaign Against "Harmful Tax Competition*," 4 Colum. J. Tax L. 1, 52–53 (2012) ("Domestic politics in several EU nations also increased interest in demonstrating that governments were 'tough' on tax evasion.").

56. A scandal in which hundreds of private letter rulings granted by the Duchy of Luxembourg were leaked to the press (LuxLeaks) was front page news all over the world but received much less coverage in the United States. In the United Kingdom, the need to "do something" about multinationals' corporate tax planning was a 2015 election issue, with the government's introduction of a new diverted profits tax on multinationals characterized as a political imperative by the Tory government. *See* Vanessa Houlder, *Business Leaders Attack UK 'Google Tax*,' Fin. Times (Dec. 10, 2014), https://www.ft.com/content/12e12e3a-7fd9-11e4-adff-00144feabdc0 (describing how the diverted profits tax was "greeted as politically astute ahead of an election campaign").

57. Angel Gurría, Sec'y-Gen., OECD, Remarks at the Meeting of the G20 Finance Ministers and Central Bank Governors in Moscow (July 20,

consolidation and social hardship, in many countries ensuring that all taxpayers pay their fair share of taxes is more than ever a priority."[58] In an interview soon after the release of the BEPS Action Plan, Gurría claimed that "[t]he perception that individuals are getting away with not paying taxes because they hide that money away in a tax haven, or that multinationals are not paying taxes when they make billions in profits, is becoming politically untenable."[59]

Along with rhetoric over fairness and equity, comments made by officials from intergovernmental organizations on the need for the BEPS project also hint at populist concerns over globalization. The BEPS Action Plan notes that globalization has "opened up opportunities for [multinational enterprises] to greatly minimise their tax burden,"[60] and that "as globalisation has changed the way business is done, the gaps and frictions that were always present" in the international tax system have become more of a concern.[61] Concerns with the fairness of international tax rules are part of a larger set of concerns over a new global order in which the old rules no longer function well. NGOs have also played a significant role in shaping the international tax policy debate to focus on issues of inequality and equity. The influence of these organizations has grown significantly over the past decade, and their advocacy was part of the stimulus that led to development of the BEPS agenda.[62]

2013) (emphasis added) (transcript available at http://www.oecd.org/about/secretary-general/joint-action-efficient-fair-taxation.htm).

58. G20 Leaders' Declaration, St. Petersburg Summit, ¶ 50 (Sept. 5–6, 2013), https://www.g20.org/Content/DE/_Anlagen/G7_G20/G20-erklaerung-petersburg-en.pdf?__blob=publicationFile&v=4 [hereinafter G20, St. Petersburg Declaration]; *see also* European Commission Memo/13/711, Commissioner Šemeta Welcomes G20 Finance Ministers' Commitments on New Measures to Fight Tax Evasion and Avoidance 1 (July 20, 2013), http://europa.eu/rapid/press-release_MEMO-13-711_en.htm [hereinafter Eur. Comm'n, New Measures Memo] (stating that the BEPS Action Plan "fully supports our common objectives to ensure that everyone pays their fair share of tax").

59. *See* Stephanie Soong Johnston, *Tax Evasion and Avoidance Now Politically Untenable, OECD Chief Says*, 72 Tax Notes Int'l 814, 814 (Dec. 2, 2013).

60. *BEPS Action Plan*, *supra* note 7, at 8.

61. *Action 15 Report*, *supra* note 16, at 15.

62. *See* Mindy Herzfeld, *News Analysis: Bursting Global Tax Bubbles*, 82 Tax Notes Int'l 315 (Apr. 25, 2016); Alexander Lewis, *U.S.*

2. Digital Economy

As originally conceived, the BEPS project focused primarily on making changes to international tax rules to address disruption to business patterns resulting from e-commerce and what was referred to as the digital economy. The G20 leaders noted in their 2013 declaration that the growth of the digital economy posed challenges for international taxation,[63] and it is no accident that the first of the BEPS action items deals with the digital economy. According to the BEPS Action Plan, the digital economy poses challenges for international taxation because it "raises fundamental questions as to how enterprises in the digital economy add value and make their profits, and how the digital economy relates to the concepts of source and residence or the characterisation of income for tax purposes."[64] It is hard enough to figure out taxing rights as between two countries when the products being sold are physical goods and the processes that give rise to making the goods involve machines and tools. When the processes and products are invisible or ephemeral, it is even harder to determine where activity is taking place and where to tax the profit.

The idea that modifications to the international tax rules were needed in order to address changes in business models caused by the rise of digital commerce was not new to BEPS. The OECD had been wrestling with these issues for years.[65] But the rise of U.S. tech companies

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Multinationals Losing Tax Reform Debate, Stack Says, 81 Tax Notes Int'l 756, 756 (Feb. 29, 2016).

63. G20, St. Petersburg Declaration, *supra* note 58, at ¶ 50.

64. *BEPS Action Plan*, *supra* note 7, at 10. In endorsing the BEPS Action Plan in July 2013, EU Tax Commissioner Algirdas Šemeta said that he "particularly welcome[d] the commitment to examine ways to overcome the tax challenges of the digital economy" and that he expected to "be working closely both within the EU and with the OECD to find answers to the complex questions that taxing the digital economy poses." Eur. Comm'n, New Measures Memo, *supra* note 58, at 1.

65. In the late 1990s, the OECD issued an Action Plan for Electronic Commerce, with Taxation Framework Conditions for e-commerce. Comm. on Fiscal Affairs, OECD, *Electronic Commerce: Taxation Framework Conditions*, A Report to Ministers at the OECD Ministerial Conference (Oct. 8, 1998), http://www.oecd.org/ctp/consumption/1923256.pdf. Subsequent reports on the topic were published in 2001. *See* OECD, *Taxation and Electronic Commerce: Implementing the Ottawa Taxation Framework Conditions* (2001),

that accumulated cash hoards of tens or hundreds of billions of dollars of low-taxed profits exacerbated the situation.

3. Cover for Politicians

Another political dynamic also played a role in the development of the BEPS Action Plan. The public furor over multinationals' tax planning provided politicians cover, or incentive, to undertake reforms that could not have been accomplished politically on their own. Some parts of the BEPS Action Plan require international coordination to accomplish. For example, changes to the OECD model treaty require consensus agreement to modify the document,[66] and changes to the OECD transfer pricing guidelines also require coordinated action.[67] Modification to the dispute resolution process for cross-border tax disputes requires coordinated action as well.

But much of the BEPS Action Plan involves recommended changes to domestic law that countries could have passed on their own. Thus, one reason for the BEPS project was to force individual governments to pass laws and shut down tax breaks either that they preferred to leave open or that would have been politically too difficult to accomplish without the cover of an international obligation. In that sense, the BEPS project was partly driven by the fact that finance ministries wanted to undertake revenue-raising reforms that might be politically impossible for elected officials to achieve otherwise. Elected leaders needed the OECD and the G20 to drive the effort to reform international tax rules because signing up for international obligations allowed politicians to counteract business lobbying efforts that opposed reform or political factions that saw tax breaks as a way to encourage investment. It also solved the first mover problem.

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http://www.oecd.org/tax/consumption/Taxation%20and%20eCommerce%202001.pdf.

66. Actions 6 and 7 of the BEPS Action Plan recommend changes to the OECD model treaty. *BEPS Action Plan*, *supra* note 7, at 19–20.

67. The United States, with its own model treaty is an exception here. The United States also has its own transfer pricing guidelines that while in many respects are consistent with OECD guidelines, in other aspects are unique. *See* U.S. Model Income Tax Convention, Feb. 27, 2016, art. 9, https://www.treasury.gov/resource-center/tax-policy/treaties/Documents/Treaty-US%20Model-2016.pdf; *see also* I.R.C. § 482 and accompanying regulations.

The G20 statements make clear that the G20 and the OECD believed that a coordinated international approach was needed because politicians lacked the moral courage or the will to undertake necessary action on their own. Similar approaches are evident in hearings conducted by the European Union's TAXE committee, formed by the European parliament to investigate tax rulings issued by E.U. member states.[68]

4. Global Power Shifts

Just as the dynamics of cross-border business have changed, so has the balance of power among Eastern and Western countries. While at the time the international tax rules were developed in the early twentieth century, many countries could be neatly categorized as either capital exporting or importing countries. The lines are now blurred, making it harder to identify which particular country would be benefited by a given rule.[69] In contrast to publicly voiced concerns over fairness and globalization, these other macro-political trends, while also a driving force for the BEPS project, were rarely spoken of publicly.[70]

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68. The United Nations has also adopted a similar view. *See* U.N. Conference on Trade & Dev., World Investment Report 2015: Reforming International Investment Governance, at 175–215, U.N. Sales No. E.15. II.D.5 (2015), http://unctad.org/en/PublicationsLibrary/wir2015_en.pdf; Eric Zolt, Tax Incentives: Protecting the Tax Base (Apr. 2015), http://www.un.org/esa/ffd/wp-content/uploads/2015/04/2015TIBP_PaperZolt.pdf (paper presented at U.N. Workshop on Tax Incentives & Base Protection, Apr. 23–24, 2015).

69. *See* Wells & Lowell, *supra* note 34, at 33 (highlighting how "former source-colony countries have . . . become residence-imperial countries"). In 2015, the United States was the largest location for inbound foreign direct investment in the world. *See* Int'l Trade Admin., U.S. Dep't of Commerce, Fact Sheet: SelectUSA Foreign Direct Investment (FDI): United States (2017), https://www.selectusa.gov/servlet/servlet.FileDownload?file=015t0000000LKSn.

70. *See* BRICS and the Emergence of International Tax Coordination 385–92 (Yariv Brauner & Pasquale Pistone eds., 2015) [hereinafter BRICS Coordination]; Amanda Athanasiou, *GWU/IRS Tax Conference: Source Versus Residence Debate Sparks Candid Comments on BEPS*, 81 Tax Notes Int'l 44 45 (Jan. 4, 2016).

Nevertheless, these global power shifts are evident in the role the OECD adopted for itself in the BEPS project. While historically the OECD was organized to address the concerns of its member countries, primarily drawn from the wealthier countries in Western Europe and North America, it expanded its agenda as part of the BEPS project to make its work more relevant to emerging market economies.[71] At the same time, its primary allegiance remains to its member countries, who fund the organization.

Although the OECD repeatedly stressed that the BEPS project did not involve a re-examination of the principles forming the basis of the international tax system[72] and was focused on eliminating tax avoidance practices, numerous statements made by emerging market countries and NGOs suggest they had alternative perceptions of the project.[73] Their comments indicate how pressure from large emerging economies influenced the OECD to adopt a broad scope for the BEPS project, including implicit reconsideration of principles that were supposedly inviolate.[74]

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71. *See* Stephanie Soong Johnston, *OECD Inclusive Framework Moving on BEPS Implementation*, 83 Tax Notes Int'l 32 (July 4, 2016); Stephanie Soong Johnston, *OECD Proposes Framework for BEPS Implementation*, 81 Tax Notes Int'l 727 (Feb. 29, 2016); *see also* OECD, *Inclusive Framework on BEPS: Progress Report July 2016–June 2017* (June 2017), http://www.oecd.org/tax/beps/inclusive-framework-on-BEPS-progress-report-july-2016-june-2017.pdf; Wells & Lowell, *supra* note 34, at 39;.

72. The BEPS Action Plan specifically states that it "*is focused on addressing BEPS*" and is "*not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income.*" *BEPS Action Plan*, *supra* note 7, at 11 (emphasis added).

73. *See* U.N. Subcomm. on Base Erosion & Profit Shifting Issues for Developing Countries, Comments Received from India to Questionnaire, http://www.un.org/esa/ffd/tax/Beps/CommentsIndia_BEPS.pdf; Wells & Lowell, *supra* note 34, at 39 ("[I]t appears that the BRICS and source countries have planted their stake in the sand, rejecting the existing order and declaring an intention to update the rules that apply to their own tax base defense."); Picciotto, *supra* note 18.

74. *See* Wells & Lowell, *supra* note 34, at 34–35 (noting that India, "[l]ike the other BRICS and many source countries of today, . . . is a serious economic power intent upon defending its own tax base, just as were the original residence countries in the 1920s" and that "[t]his emergence is a transformative element of the treaty policy dialogue").

The BRICS (Brazil, Russia, India, China, and South Africa) countries in particular have been vocal in articulating opposition to the existing treaty system as detrimental to their economies.[75] Comments submitted by India's representative to the U.N. tax committee reflect the view of some emerging market countries that the international tax rules do not work to their benefit. In comments submitted to the U.N. in 2012 in opposition to a point of contention in the U.N. model treaty, the Indian delegate noted: "The OECD principles have evolved from the perspective of only developed countries since they were prepared by the OECD countries, and many issues relating to developing countries have not been taken into consideration."[76] The comments state that reliance on OECD developed standards "has resulted in serious curtailment of the taxing powers of the developing countries in relation to international transactions," and that they therefore "should not be taken as internationally agreed 'standards.'"[77]

The debate over whether the current allocation of taxing rights under the OECD model treaty reflects the interests of developing countries was percolating prior to the start of the BEPS project. But it became more pronounced because the G20 mandated that the OECD process be opened up to take the views of BRICS economies into account as full participants in the OECD consensus process. This process allowed the OECD to segue into a role that includes rule setting, not just for OECD member countries but for a larger group of nations as well. Its new inclusive framework, an outgrowth of the BEPS project that includes many countries outside of the OECD in the consensual process for making policy decisions relating to global tax issues, highlights how the OECD's role has expanded.[78]

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75. *See* Dagan, *supra* note 12; Wells & Lowell, *supra* note 34, at 4; *see also* Mindy Herzfeld, *News Analysis: Who Will Control the Future of International Tax Policy?*, 78 Tax Notes Int'l 419, 420 (May 4, 2015).

76. Permanent Mission of India to the U.N., Comments on the United Nations Model Double Taxation Convention Between Developed and Developing Countries 1, Doc. No. PM I/NY/DPR/2012 (Aug. 13, 2012), http://www.un.org/esa/ffd/wp-content/uploads/2014/10/ta-unmodel-LetterIndia_13aug12.pdf [hereinafter India Comments].

77. *Id.*; *see* Mindy Herzfeld, *News Analysis: India and the United States—Half a World Apart on Tax*, 84 Tax Notes Int'l 953 (Dec. 12, 2016).

78. *See* Stephanie Soong Johnston, *G-20 Finance Ministers Approve BEPS Framework*, 81 Tax Notes Int'l 819 (Mar. 7, 2016).

An initiative launched by BRICS countries for coordination and cooperation of tax policy and tax administration[79] is not so different from the increasingly assertive stance being taken by a number of these countries on other issues of international economic policy.[80] The fact that in the BEPS project the OECD was forced to take account of the political and revenue goals of emerging market countries is part of the context of a larger debate over the need for change in global financial institutions that have retained post–World War II power balances.[81] Another example of this flexing of muscles by emerging markets is the New Development Bank, formed by the BRICS countries,[82] and the Asian Infrastructure Investment Bank, an infrastructure bank led by China. In announcing the launch of the New Development Bank, the Chinese Finance minister said: "This bank will place greater emphasis on the needs of developing countries, have greater respect for developing countries'

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79. *See* Communiqué of BRICS Heads of Revenue Meeting Issued in New Delhi (Jan. 18, 2013), *reprinted in BRICS Countries Agree Further Tax Policy Cooperation Needed*, 2013 Worldwide Tax Daily 15–27 (Jan. 23, 2013) (announcing the cooperation agreement between Brazil, Russia, India, China, and South Africa: "We [BRICS countries] agree to extend the cooperation on the following issues of tax policy and tax administration: (i) contribute to development of International Standards on International Taxation and Transfer Pricing taking into account the aspirations of developing countries in general and BRICS Countries in particular. . . ." Memorandum of Cooperation Between the Secretariat of the Fed. Rev. of the Federative Republic of Braz., the Fed. Tax Serv. of the Russian Fed'n, the Dept. of Rev. of the Ministry of Fin. of the Republic of India, the State Admin. of Tax'n of the People's Republic of China & the S. African Rev. Service of the Republic of S. Afr. (Jul. 27, 2017), http://idg.receita.fazenda.gov.br/noticias/ascom/2017/julho/receita-federal-participa-de-reuniao-dos-paises-brics/moc-signing-version.pdf.

80. *See* BRICS Coordination, *supra* note 70, at 3–4.

81. As the U.S. 2016 election illustrated, such pressures are coming from the United States as well.

82. *See, e.g.*, BRICS Countries Launch New Development Bank International Centre for Trade and Sustainable Development, Bridges Weeekly, July 17, 2014, at 1, 1, https://www.ictsd.org/sites/default/files/review/bridgesweekly18-26.pdf. This new development bank was launched by the BRICS countries in direct response to the failure of the World Bank and the IMF to revise their system of decision-making process to give more of a voice to developing countries. Id. at 2.

national situation, and more fully embody the values of developing countries."[83]

These trends highlighted the risks to the OECD of not bending its own tax rulemaking process to accommodate the participation and positions of developing countries. The OECD needed to make the BEPS project broader rather than narrower to prevent the possibility that an alternative international rulemaking body would develop. In that respect, BEPS was partly a test case for the OECD as to whether it could accommodate the policy goals of the BRICS and other countries as part of the BEPS mandate. The reform agendas of these countries go far beyond those of restricting base erosion and profit shifting practices. As discussed further below, China and India in particular viewed the project as a way to revisit fundamental principles of the international tax system.[84]

There is another aspect to the story of how global power shifts prompted large developed countries to advocate for the BEPS project. As financial markets opened up and trade barriers fell, international trade forced developed countries to become more competitive to sustain their welfare states. Restricting tax competition was one way for them to continue to survive while providing the same benefits to their populations.[85] It presented the opportunity to muscle smaller (developed) countries that had become financial centers out of the picture.[86]

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83. As quoted in Gabriel Wildau, *New Brics Bank in Shanghai to Challenge Major Institutions,* Fin. Times (July 21, 2015), https://www.ft.com/content/d8e26216-2f8d-11e5-8873-775ba7c2ea3d; *see also* Gabriel Wildau & Charles Clover, *AIIB Launch Signals China's New Ambition*, Fin. Times (June 29, 2015), https://www.ft.com/content/5ea61666-1e24-11e5-aa5a-398b2169cf79.

84. *See infra* Part II.A.

85. *See* Morriss & Moberg, *supra* note 55, at 4 ("Until relatively recently, larger developed economies have been sheltered from some of the competition to attract economic activity by the combination of the costs of conducting international transactions and the barriers to such transactions. . . . As these barriers declined and investors grew more sophisticated at using international financial structures to reduce tax burdens on international transactions, states whose economies' size had previously been sufficient to make them attractive locations for investment found themselves struggling to capture revenue from increasingly internationalized transactions.").

86. *See generally id.*

5. The OECD's Role

Historically, the OECD's tax agenda has formed a subset of its broader mission, which is to facilitate economic development and cross-border trade.[87] Decision-making at the OECD is by consensus, meaning that any one country can effectively block a reform from moving forward. The OECD's tax function has traditionally moved slowly, and modifications to the language of the OECD model treaty have often taken years if not decades to finalize.[88]

However, the leadership of the tax organization responded eagerly to the G20's invitation to expand and shift its traditional role in international tax policy, making attacking tax avoidance, with a necessary ancillary attack on global companies' actions, a focus of its work. In the BEPS project, the OECD learned its lessons from prior unsuccessful efforts in this area. The BEPS project provided a vehicle for the OECD tax committee, which was arguably becoming less relevant in a world where economic power was shifting to the East, to take on a role as key arbiter of global tax rules.[89] In so doing, it strengthened its organization—and the careers of its bureaucrats.[90]

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87. The OECD is the successor of the Organisation for European Economic Cooperation, which formed after World War II to promote economic development, including facilitation of free trade, beginning with the implementation of the Marshall plan. *Organisation for European Economic Cooperation*, OECD, http://www.oecd.org/general/organisationforeuropean-economicco-operation.htm (last visited Sept. 26, 2017). For a brief history of the origins of the OECD, see Joint Comm. on Tax'n, 114th Cong., JCX-139-15, Background, Summary, and Implications of the OECD/G20 Base Erosion and Profit Shifting Project 2–8 (Nov. 30, 2015).

88. The committee is led by technical experts acting as representatives of the developed economies, which provides for a technocratic, bureaucratic, bottom-up procedure. *See* Grinberg, *supra* note 13, at 1147–48.

89. *See* Philip Baker, *Is There a Cure for BEPS?*, 5 Brit. Tax Rev. 605, 606 (2013).

90. *See* Morriss & Moberg, *supra* note 55, at 57. The significant role played by individual leadership in the effectuation of the BEPS Action Plan must be mentioned. In Pascal Saint-Amans, Director, Center for Tax Policy and Administration at the OECD from the start of the BEPS project, the international coordination project found someone with the skills and motivation to move the project from conception to completion. *See* Stephanie Soong Johnston, *Pascal Saint-Amans—The Face of BEPS,* 2014 Worldwide Tax Daily

II. Weak Foundations

While countries and international organizations in 2012 could point to many different reasons why a coordinated effort to reform international tax rules made sense, particularly in the case of minimizing revenues lost to governments as a result of multinationals' base erosion and profit shifting activities, as the BEPS project swept forward with a momentum of its own, the coordinated effort mostly ignored the underlying issues that gave rise to the challenges that the project was supposed to address. In this section, I show how the underlying premises for the coordination efforts undertaken in the BEPS project were flawed, necessarily leading to problematic outcomes. In highlighting progress in coordination efforts, policy makers and government officials were able to paint over major policy differences.

A. Global Politics

1. No Agreement on Allocation

The BEPS action items required technical revisions to existing domestic tax rules and international agreements such as bilateral tax treaties. But while an implicit assumption embedded in the agreement to change a law is that there is agreement on the principle and policy behind the changes, such agreement never existed in the case of the BEPS project. To the extent countries in the 1920s had reached a general agreement over how multinationals' global profits should be allocated, such consensus no longer exists. The BEPS project never acknowledged this lack of agreement, highlighted in comments from countries such as China and India on various aspects of the project. The lack of agreement on

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245–1 (Dec. 22, 2014). The G20 may have desired international tax reform, but without someone in the leadership capacity with Saint-Amans' skills and motivation, the BEPS Action Plan may have ended up as little more than a footnote in a G20 letter. See introduction by David Rosenbloom to the 2015 Tillinghast lecture presented by Saint-Amans, noting that Saint-Amans had accomplished "what is pretty close to a miracle, steering the BEPS project through a three year process to completion" and capturing the attention of millions of people in the process. Carlo Olivar, *2015 Tillinghast Lecture by Pascal Saint-Amans at NYU School of Law*, YouTube (Oct. 26, 2015), https://www.youtube.com/watch?v=qUy-_gHe-Mg.

principles meant that it was practically impossible to reach meaningful consensus on the details of rules.

Achieving consensus is challenging because the different roles that countries play in the world economy mandate that they advocate for competing international tax policies. Consider, for example, a vastly simplified characterization of the different roles the United States, France, China, and Brazil play within the world economy. The U.S. economy thrives on innovation, and the intellectual property developed by its resident multinationals is one of the biggest drivers of growth and source of profits for its resident companies.[91] France, in contrast, supports employment in its jurisdiction by charging higher prices for products produced, and sold, within the country. While China has been a global engine of growth for much of the past decade, this growth has been to a large extent driven by its ability to promote low-cost manufacturing through the capacity of its very large population to work for low wages and through exports. Brazil, like many other developing economies, relies to a large extent on the export value of its commodities. While these are gross generalizations that gloss over many of the different facets of the different economies, they also illustrate why countries take different positions on how international tax rules should be designed to allocate multinationals' profits among different countries.

Because the U.S. economy derives significant value from its corporate residents' development of intellectual property, it in theory should have a strong interest in an international tax system that allocates taxable profits in accordance with the development of "value," as defined relative to intellectual property.[92] France, which lacks a strong base of

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91. *See* Kevin G. Rivette et al., *Discovering New Value in Intellectual Property*, Harv. Bus. Rev. (Jan.–Feb. 2000), https://hbr.org/2000/01/discovering-new-value-in-intellectual-property; *Measuring and Analyzing the Impact of GVCs on Economic Development* (World Bank, Working Paper No. 117290, 2017), http://documents.worldbank.org/curated/en/440081499424129960/Measuring-and-analyzing-the-impact-of-GVCs-on-economic-development [hereinafter *Measuring the Impact*].

92. In reality, the U.S. position is muddled due to the fact that, unlike most of the world, it taxes the worldwide income of its resident taxpayers. In practice, this worldwide system provides its multinationals with significant incentives to keep their profits out of reach of the U.S. tax net and to move high-value intangibles overseas into low-tax jurisdictions. *See* Edward Kleinbard, *Stateless Income's Challenge to Tax Policy*, 68 Tax Notes Int'l 499, 504 (Oct. 29, 2012) ("It is more accurate to say that in practice and as used by

profitable and innovative companies in high-tech industries, instead advocates for international tax rules to be revised to allow greater possibility for assessing corporate income tax at point of sale (where the market is).[93] Countries such as Brazil that rely heavily on the export of natural resources want greater emphasis on withholding taxes. China, a country whose economic strength has historically depended on its large labor force, would like to see the allocation principles place more stress on human capital factors (including its market) than other types of capital.

As part of the revision to transfer pricing guidelines in the BEPS project, the OECD undertook a revision of guidelines for the profit split method, a controversial method of transfer pricing.[94] Comments submitted by Chinese academic institutions on the first version of the profit split draft illustrate the extent to which the Chinese authorities viewed the BEPS project as an opportunity to revisit international tax principles.[95] These comments stated that, while "[i]n the past, the [transfer

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sophisticated multinational firms, the U.S. tax system operates as an ersatz territorial tax regime. . . ."). But as the negotiating positions of the U.S. Treasury in the BEPS project show, the United States still retains a strong interest in ensuring that the value derived from U.S.-developed intellectual property is not taxed elsewhere, because it retains the possibility of being repatriated to the United States. *See* Robert B. Stack, *U.S. Treasury Officer Discusses the Progress and Future of BEPS*, 78 Tax Notes Int'l 1193 (Jun. 29, 2015) (remarks delivered by Stack to the OECD/U.S. Council for International Business Tax Conference [Jun. 10, 2015]).

93. The United States and France were co-leaders of the digital economy project and had very different views. *See* Ryan Finley, *Stack Reflects on Turbulent Days at Treasury*, 85 Tax Notes Int'l 1045 (Mar. 20, 2017).

94. The United States, the OECD, and the U.N. have each expressed concerns as to the choice of the profit split method and how it will be used. For example, the BEPS final report on Actions 8–10 cautioned countries against using the profit split method too proactively. *See BEPS Transfer Pricing Report*, *supra* note 23, at 55–62. In its discussion draft on the profit split method issued in July 2016, the OECD cautioned, "lack of comparables alone is insufficient to warrant the use of a transactional profit split of actual profits under the arm's length principle." OECD, *Public Discussion Draft: BEPS Actions 8–10: Revised Guidance on Profit Splits*, at 8 (July 2016), https://www.oecd.org/tax/transfer-pricing/BEPS-discussion-draft-on-the-revised-guidance-on-profit-splits.pdf.

95. *See* China International Tax Center & IFA China Branch, Comments on Discussion Draft on the Use of Profit Splits in the Context of Global

pricing] mechanism focuses on only the supplier side of enterprises with no emphasis of the market and no mentioning of the government," such old-fashioned concepts needed to be "upgraded."[96] The Chinese comments stated, "the transfer pricing outcomes shall be in line with not only value creation, but also value realization."[97] They also argued that the arm's length standard should be combined with a new principle, the "fair-share-principle," because the arm's length principle fails to reflect the "exterior contributions from the markets and the governments."[98] The Chinese comments thus illustrate a vision for a more radical rewrite of international tax rules than those stated in the OECD's agenda.

The BEPS project charted new territory in focusing on value creation as the determinant for profit allocation.[99] But value creation is an incoherent and ill-defined notion, and not all countries were aligned on this idea. For example, China argued for a rejection of the concept of value creation in favor of an alternative notion of value realization, an idea that gave the market relevance as a factor in the pricing of goods transferred across borders. Relying on market realization as an allocation factor would likely mean that China would be allocated a greater share of a global company's profits. And China does not necessarily

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Value Chains and Other Related Transfer Pricing Issues (Feb. 6, 2015), *in* OECD, *Comments Received on Public Discussion Draft: BEPS Action 10*, at 100–102 (Feb. 10, 2015), http://www.oecd.org/tax/transfer-pricing/public-comments-action-10-profit-splits-global-value-chains.pdf [hereinafter China IFA Comments]; *see also* Mindy Herzfeld, *Splitting Profits with Communists*, 79 Tax Notes Int'l 467 (Aug. 10, 2015).

96. China IFA Comments, *supra* note 95, at 101.

97. *See id.* The comments state that: "Both value creation and value realization enable a value [to] become[] a value. In this way, the role of the enterprises and markets are clearer and their contribution to the value will be easier to be identified and differentiated." *Id.*

98. The Chinese comments advocate adoption of a formulary apportionment system to replace the arm's length standard, arguing that, "the simpler Formulary Method which takes care of all important contributing elements will better illustrate the Fair-Share-Principle." *Id.*

99. The BEPS Action Plan mandate for revision of the transfer pricing guidelines is to "assure that transfer pricing outcomes are in line with value creation." *BEPS Action Plan*, *supra* note 7, at 20–21 (describing Actions 8, 9, and 10); *see* Michael P. Devereaux & John Vella, *Are We Heading Towards a Corporate Tax System Fit for the 21st Century*?, 35 Fiscal Studies 449, 463–68 (2014).

agree that a company's profits are solely attributable to the arm's length factors of assets, functions, and risks,[100] but its comments highlight the market and the government as two additional value contributors that must be considered in the arm's length analysis.[101] The theory of value realization advocated by the China IFA Comments suggests that, because it is ultimately the consumers who provide value to a business, a country with more consumers deserves to be credited with a greater share of business profits. Similar themes are also evident in recent proposals by academics in the United States.[102]

The fact that Chinese institutions submitted suggestions for rewriting the rules in accordance with principles that diverge from the arm's length principle as comments on a BEPS discussion draft, while simultaneously participating on a consensus basis in a project that

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100. *See* China IFA Comments, *supra* note 95, at 100–02.

101. The comments from IFA's China Branch and the China International Tax Center (China IFA Comments, *supra* note 95) are written on the letterhead of Beijing's Central University of Finance and Economics, which is supported by the Chinese government. *See State 211 Project*, PhD Workshop China, http://www.phdchina.org/phd/english/general/State_211_Project.pdf (last visited Sept. 26, 2017). The comments suggest that the unique role of the Chinese government warrants a greater allocation of profits to China:

> Especially in the case of the Chinese government, it is not only an expenditure unit in compensation for passive public service of security, but also an active investing party in the economy who then shall enjoy the surplus of the out-puts; the Chinese government undertakes more functions than other "market economy governments". . . .

China IFA Comments, *supra* note 95, at 102. Furthermore, the comments state that while the government has not been recognized "as a producing unit in the past; in the modern economy, its macro productive force is increasing[ly] accepted by the society." *Id*.

102. *See S. Comm. on Fin. Hearing on International Tax Reform*, 115th Cong. (Oct. 3, 2017), https://www.finance.senate.gov/hearings/international-tax-reform (statement of Itai Grinberg, Professor of Law, Georgetown Univ. Law Ctr.); Michael Graetz and Rachel Doud, *Technological Innovation, International Competition, and the Challenges of International Income Taxation,* 113 Columb. L. Rev. 347 (2013); Bret Wells & Cym Lowell, *Tax Base Erosion and Homeless Income: Collection at Source Is the Linchpin* 65 Tax Law. Rev 535 (2011).

endorsed that principle, illustrates the wide split on fundamental principles of the international tax system among BEPS participants. Such differences exist not just between the developing and the developed world. Significant disagreements over the proper basis for assessing the income tax were evident over the course of the BEPS debate between the United States and many European countries. These differences played out in the BEPS report on the digital economy, which was co-led by two countries with widely conflicting views on the question of how profit derived from the digital economy should be taxed.[103]

In addition to disagreements among countries, the NGOs whose voices were instrumental in getting the OECD to undertake the project consistently questioned its parameters. Throughout the project, for example, the BEPS Monitoring Group argued that the fundamental problem with the current international tax rules was that they respected legal entities as separate persons.[104]

Simply put, there was no agreement among the parties negotiating changes to the international tax rules as to the appropriate balance between taxation based on source versus residence.[105] Generally speaking, a system that gives priority to residence as a means of taxation is likely to favor richer countries, whose residents channel capital to developing countries, while giving greater priority to source may favor developing countries whose only basis for tax may be the activities being

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103. The United States, which continues to adhere to the principle that profits should be taxed where the value-producing assets reside, while France and some other countries profess to favor a tax base that looks to the market for digital products. While concerns over whether the existing tax system adequately captured profits from the digital economy were at the root of the BEPS project, Action 1 of the project, which was supposed to "[i]dentify the main difficulties that the digital economy poses for the application of existing international tax rules and develop detailed options to address these difficulties," did not produce any detailed recommendations due to lack of consensus. OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1: 2015 Final Report*, at 16, 142–49 (2015), http://dx.doi.org/10.1787/978 9264241046-en.

104. *See* BEPS Monitoring Group, *BEPS Monitoring Group Evaluates OECD BEPS Project*, 2015 Worldwide Tax Daily 193–33 (Oct. 6, 2015).

105. *See* Amanda Athanasiou, *Source Versus Residence Debate Sparks Candid Comments on BEPS*, 150 Tax Notes 67 (Jan. 4, 2016).

conducted within their jurisdiction. But even those demarcations are no longer necessarily valid in an age when capital flows both ways.[106]

Lack of agreement about the principles on which global profits will be allocated poses challenges to an international effort of coordination premised on the goal of strengthening the operating rules that implement those principles.

2. Global Politics—Shifts in Balance of Power

An international tax system that was developed by, and arguably in the interest of, richer developed countries to the disadvantage of developing countries was the basis for the international tax system for close to a century. But shifts in the global balance of power mean that inequalities resulting from such a system—whether perceived or real—are no longer sustainable.[107] As emerging markets that are becoming ever more dominant in the global economy assert their interests in international tax policy more aggressively, this perception of an unequal system poses an additional constraint on the ability to reach consensus on modifications to current rules. Shifts in global power balances mean that some countries no longer feel that the status quo is advantageous to them, and they are willing to express their positions. This too creates challenges for reaching agreement on a set of rules.

Comments from India on the U.N. model tax convention are relevant here. India's representative to the U.N. tax committee objected to what was described as the U.N. tax committee rubber stamping the OECD's tax guidelines:

> The Committee of Experts and its predecessor Ad Hoc Group of Experts have not been able to appropriately reflect all the concerns of developing countries, as the proceedings in the Committee and its sub-Committees tend to be dominated by experts from the OECD countries, low tax jurisdictions and non-governmental

106. *See China's Outbound Investment Jumps, Catching Up with FDI*, Reuters (Jun. 18, 2015, 10:34 PM), http://uk.reuters.com/article/uk-china-investment-fdi-idUKKBN0OY07420150618; Mindy Herzfeld, *News Analysis: Taxing Inbound Sales*, 88 Tax Notes Int'l 203 (Oct. 16, 2017).

107. *See generally* BRICS Coordination, *supra* note 70.

> observer-representatives. An inter-Governmental Commission with balanced representation from countries at various stages of development would be a preferred organization to develop international standards for adoption by the countries. Only a commission of such nature can play a crucial role in fostering dialogue and cooperation between national tax authorities and ensure that the views of the developing countries do not get ignored, particularly when the positions of the developed countries on issues on which they have a consensus, are challenged.[108]

When agreement was hashed out over a model tax agreement that became the OECD model convention in the early twentieth century, it was among countries with relatively equal economic clout. As the international tax rulemaking process expanded in BEPS to include the larger emerging economies in addition to historical OECD members, parties' divergent interests made it harder to coordinate a single set of rules. If emerging countries see the international tax rules as a way to assert their growing global economic power, it becomes harder to agree on the rules that should apply to all.[109]

In addition, the least developed countries, which were not part of the BEPS project initially but now have a role within the BEPS inclusive framework,[110] also believe that the current system is inherently biased against them. As a result, they resist changes to the model treaty that enforce existing principles. Such protests against the existing system are made clear in the outputs of the U.N. tax committee.[111]

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108. India Comments, *supra* note 76, at 1.

109. *See* Mindy Herzfeld, *India and the United States: Half a World Apart on Tax*, 84 Tax Notes Int'l 953, 958 (Dec. 12, 2016).

110. *See* OECD, *Background Brief: Inclusive Framework on BEPS*, at 10–14 (Jan. 2017), http://www.oecd.org/tax/beps/background-brief-inclusive-framework-for-beps-implementation.pdf [hereinafter *OECD Inclusive Framework*].

111. The 2017 version of the U.N. model treaty includes a new article that greatly expands taxation at source. *See* Comm. of Experts on Int'l Cooperation in Tax Matters, Taxation of Services: Report of the Coordinator, U.N. Doc. E/C.18/2016/CRP.1 (Oct. 11–14, 2016), http://www.un.org/esa/ffd/wp-content/uploads/2016/10/12STM_CRP1_Services.pdf; *see also* Andrés Báez Moreno, *The Taxation of Technical Services Under the United Nations Model*

B. Domestic Politics

1. Power to Tax Means Political Power

Any effort to coordinate international tax rules necessarily involves a loss of sovereignty and hence of domestic political power. The compromise necessary to reach international agreement consequentially dilutes the local politician's ability to be responsive to constituents.[112] Julie Roin, in *Taxation Without Coordination*, argues, "Tax base harmonization reduces legislative control over national tax policy without creating a corresponding increase in control over worldwide tax policy."[113] The fact that the United States may have lots of influence to shape international tax rules at the OECD doesn't help individual congresspersons trying to secure advantages for their constituents. With the ability to write tax laws and give tax breaks comes political power, and, according to Roin, legislators are keenly aware of the loss to their own power that accompanies significant attempts to assign such power to an international organization, such as loss of opportunity to grant special favors, while "receiving accompanying recompense." The more power an international organization charged with harmonizing tax laws amasses, the more political opportunities are potentially lost to local politicians.[114]

While G20 finance ministers have lauded the BEPS project as providing the opportunity to recoup a missing $200 billion from the global economy in the form of stateless income, locally elected politicians may see less benefit. Roin's point that "tax base harmonization will not

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Double Taxation Convention: A Rushed—Yet Appropriate—Proposal for (Developing) Countries?, World Tax J., Sept. 17, 2015, https://online.ibfd.org/kbase/#topic=doc&url=/collections/wtj/html/wtj_2015_03_int_2.html&WT.z_nav=Pagination.

112. On the importance of political responses to local needs in setting domestic tax policy, see James Hines, High Tax Heresy 13 (Jan. 2016), http://www.law.georgetown.edu/faculty/symposia-lectures/tax-law-public-finance/upload/High-Tax-Heresy-Jan-2016.pdf ("In well-run democratic societies the legislatures choose tax policies, thereby implicitly or explicitly attaching weights to equity, efficiency, administrability, and possibly other considerations.").

113. Julie Roin, *Taxation Without Coordination*, 31 J. Legal Studies S61, S79 (Jan. 2002). Roin further notes, "National legislators thus would lose a significant element of political power, power that generates benefits in the form of campaign donations, honoraria, and other in-kind benefits." *Id.*

114. *Id.* at S79–S86.

necessarily provide governments with enough additional revenue to fully compensate their politicians for the concomitant losses of political control" is particularly salient in the context of the BEPS project.[115] Local politicians' interests are not necessarily in sync with those of tax technocrats who negotiate international rules in a technical body.

International coordination also may conflict with domestic policy goals. Robert Stack, who had a unique vantage point as U.S. Deputy Assistant Treasury Secretary for International Tax Policy during the time period when most of the negotiation over the BEPS project took place, repeatedly reflected on how the possibility of significant change in international tax rules resulting from BEPS ultimately ran head-on into nationalist interests.[116] The fact that international coordination efforts may play out at the expense of a loss of power to domestic politicians is relevant because it motivates them to impose roadblocks to successful conclusion of the effort.

2. The Need to Encourage Investment (E.g., Patent Box)

The views of tax experts as to optimal tax policy often runs head-on into the domestic politics around tax incentives. Economists generally disfavor tax incentives designed to attract foreign investment, consistently questioning whether tax incentives geared towards encouraging foreign investment produce a net economic benefit. There is widespread consensus among academic economists that developing countries, and in particular the least developed countries, suffer from an overuse of tax incentives.[117] The concern also exists in developed countries but is less acute because corporate tax revenues represent a smaller share of their budgets.

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115. *Id.* at S83.

116. *See* Amanda Athanasiou, *Competitive Interests Preventing Consensus on CFCs, Stack Says*, 2015 Worldwide Tax Daily 96–3 (May 19, 2015); Stack, *supra* note 92; *see also* Graetz & O'Hear, *supra* note 2, at 1042 ("[I]t is hard to convince a U.S. President or members of Congress to put aside 'narrow' national interests to fashion U.S. tax policy in a manner that is indifferent to whether taxes flow into U.S. coffers or the treasury of some foreign nation.").

117. *See, e.g.*, Alexander Klemm & Stefan Van Parys, *Empirical Evidence on the Effects of Tax Incentives*, 19 Int'l Tax & Pub. Fin. 393 (2012).

In 2015, the IMF released a working paper examining the costs and benefits of tax incentives that aim to encourage investment.[118] The paper concluded that:

> IOs [international organizations] and many other observers have often found tax incentives to be ineffective, inefficient and associated with abuse and corruption. As a result, they have frequently advised countries to remove them or to improve their design, transparency and administration. Yet, this advice has often had limited effect. The common reluctance to scale back incentives—perhaps even . . . a tendency for them to proliferate—may reflect vested interests, political inertia, and tax competition with other countries.[119]

The IMF paper noted the challenges inherent in persuading politicians on this point, acknowledging "reform of tax incentive regimes has proven difficult."[120] The IMF paper says that "politicians may find it attractive to introduce new tax incentives to reveal their proactive stance in addressing weak economic performance, or to favor particular regions."[121]

The increasing prevalence of the patent box—simultaneously with countries' commitment to the BEPS project—highlights the tensions between sound economic policy, coordination of tax rules, and local desires for tax incentives to encourage foreign investment.[122] In theory, the patent box regime,[123] in which countries adopt a lower tax rate on income from intellectual property, encourages research and development activities in the country offering the incentive. But studies have shown that this is rarely the case. European Commission researchers have demonstrated a tenuous connection between tax benefits conferred

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118. *IMF Incentives Report*, *supra* note 45.

119. *Id*. at 6 (footnote omitted).

120. *Id*. at 28.

121. *Id*.; *see also* Zolt, *supra* note 68.

122. *See* Mindy Herzfeld, *News Analysis: The Politics of the U.S. Patent Box*, 79 Tax Notes Int'l 905 (Sept. 14, 2015).

123. The patent box is also frequently referred to as a "knowledge box" or an "IP box."

through a patent box and an increase in R&D activities that a patent box is supposedly designed to produce.[124] They conclude, "the tax advantage of patent boxes tends to deter local innovative activities, given the lack of incentives for companies to develop local research."[125] After surveying different countries' patent boxes, economists at the Centre for European Economic Research concluded that they are generally poorly designed to encourage investments in R&D.[126]

Yet despite rigorous economic data that suggests the need for skepticism about the efficacy of the patent box, countries continue to adopt such regimes. Patent boxes have been around since the early 2000s—France's incentives date to 2001 and Hungary's to 2003. But the frequency of adoption has increased in recent years. Since 2003, at least ten other countries have adopted them, including Belgium, Cyprus, the Netherlands, Luxembourg, and the United Kingdom.[127] In conjunction

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124. Annette Alstadsæter et al., *Patent Boxes Design, Patents Location and Local R&D* 22–24 (European Comm'n Tax'n Papers, Working Paper No. 57-2015, June 2015), http://goo.gl/ikHIXt.

125. *Id*. at 4.

126. Lisa Evers et al., *Intellectual Property Box Regimes: Effective Tax Rates and Tax Policy Considerations*, 22 Int'l Tax & Pub. Fin. 502, 525 (2015). In a series of articles published in *Tax Notes*, economist Martin Sullivan has also laid out a case against the patent box, arguing that encouraging innovation through a patent box produces worse results with more complexity than providing tax benefits to encourage inputs, such as increased spending on R&D. *See* Martin Sullivan, *Economic Analysis: Can a Patent Box Promote Advanced Manufacturing?*, 147 Tax Notes 1347 (June 22, 2015); Martin Sullivan, *Economic Analysis: Do Patent Boxes Move More Than Patents?*, 148 Tax Notes 243 (July 20, 2015); Martin Sullivan, *Economic Analysis: A History Lesson for a Future Patent Box*, 148 Tax Notes 1036 (Sept. 7, 2015); *see also* Graetz & Doud, *supra* note 102.

127. *See* Joint Comm. on Tax'n, 113th Cong., JCX-90–14, Present Law and Background Related to Proposals to Reform the Taxation of Income of Multinational Enterprises 53 (2014); Evers et al., *supra* note 126, at 503–04; Domenico Borzumato & Annalisa Vergati, *News Analysis: Italy's Finance Bill—Tax as a Tool for Growth*, 2014 Worldwide Tax Daily 226-8 (Nov. 24, 2014); J.P. Finet, IP Box, Country-by-Country Reporting Featured in Irish Budget, 2015 Worldwide Tax Daily 198–3 (Oct. 14, 2015); *Patent Boxes, Technological Innovation and Implications for Corporate Tax Reform*, Am. Action F. (Feb. 22, 2016), https://www.americanactionforum.org/research/patent-boxes-technological-innovation-implications-for-corporate-tax-reform/. Other countries that have announced plans to introduce a patent box in light

with new guidelines offered as part of the BEPS project for patent boxes, even more countries have jumped on this bandwagon, including Ireland, Italy, and Switzerland. In 2015, Congressmen Charles Boustany of Louisiana and Richard Neal of Massachusetts introduced a discussion draft for a patent box proposal in the U.S. Congress (the Innovation Promotion Act of 2015).[128] And the idea remains popular in the United States, although it has been overshadowed in recent tax reform debates.[129]

Throughout the course of the BEPS project, the OECD repeatedly emphasized that the project was not about harmonizing rates but instead about eliminating gaps that facilitate abusive planning. In response to the BEPS recommendations, countries that previously relied on such gaps to encourage foreign investment announced plans to lower their overall rates. These included the United Kingdom, which introduced a plan to lower its corporate income tax rate from the already low 20% to 17%.[130] In November 2016, Hungarian Prime Minister Viktor Orbán committed to reducing Hungary's corporate income tax rate to nine percent.[131]

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of BEPS include Singapore and Mauritius. *See* Amanda Athanasiou, *Singapore's 2017 Budget Gives Nods to BEPS, Innovation,* 2017 Worldwide Tax Daily 34–3 (Feb. 22, 2017); Stephanie Soong Johnston, *Mauritius Proposes Innovation Box, Moving in Line With Global Tax Norms*, 2017 Worldwide Tax Daily 111–4 (June 12, 2017).

128. Innovation Promotion Act of 2015, Discussion Draft, 114th Cong. (July 2015), https://waysandmeans.house.gov/wp-content/uploads/2015/07/Innovation-Box-2015-Bill-Text.pdf; *see also* Manufacturing Innovation in America Act of 2013, H.R. 2605, 113th Cong. (2013). *See generally* Jane G. Gravelle, Cong. Research Serv., R44522, A Patent/Innovation Box as a Tax Incentive for Domestic Research and Development (2016).

129. *See* Stephen K. Cooper, *Innovation Box Proposal Still Evolving, Neal Says*, 2016 Tax Notes Today 101–5 (May 25, 2016).

130. HM Rev. & Customs, *Corporation Tax to 17% in 2020*, Gov.UK (Mar. 16, 2016), https://www.gov.uk/government/publications/corporation-tax-to-17-in-2020/corporation-tax-to-17-in-2020; *see also* Stephanie Baker, *U.K. Cuts Corporation Tax Rate Again in a Boon to Britain Plc*, Bloomberg News (Mar. 16, 2016, 12:26 PM) https://www.bloomberg.com/news/articles/2016-03-16/u-k-cuts-corporation-tax-rate-again-in-a-boon-to-britain-inc; Helen Miller, *What's Been Happening to Corporation Tax?*, Inst. for Fiscal Stud. (May 10, 2017), https://www.ifs.org.uk/publications/9207.

131. Amanda Athanasiou, *Hungarian Prime Minister Unveils Single-Digit Corporate Tax Rate*, 2016 Worldwide Tax Daily 224–4 (Nov. 18, 2016).

The international competition for investment through tax incentives is often portrayed as a harmful race to the bottom. But it can alternatively be characterized as an important exercise of political autonomy and sovereignty. Some academics warned early in the BEPS project that if the OECD was successful, "domestic policy decisions constrained by competition among jurisdictions to attract capital will be transformed into international decisions dominated by a cartel of wealthy nations."[132] Evidence of such cartel-like behavior is demonstrated through the results of BEPS Action 5.[133] Ostensibly an attempt to cut down on harmful tax practices, the dominant role played by countries such as Germany and the United Kingdom in setting parameters for the patent box regime meant that the final rules worked to the benefit of their countries' unique qualities and to the detriment of others.

In its efforts to persuade countries to commit to foregoing offering special tax incentives, the BEPS project ran head on into local political considerations and provided the most benefit to those countries that had the loudest voice at the negotiating table.

C. Value Creation

The BEPS project is based on the assumption that the right to tax corporate profits belongs to the jurisdiction where economic activities take place and the jurisdiction where value is created.[134] But the OECD, in articulating this standard, glossed over the fact that in setting such a goal it was superimposing a brand new standard on the international tax system, which had never considered the allocation of profits based on value creation.[135]

First, it is questionable whether the jurisdiction where economic activities take place is always the same jurisdiction where the greatest value is created. If economic activities are correlated with the number of people employed (as many developing countries assert), and fairness

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132. Morriss & Moberg, *supra* note 55*; see also* Dagan, *supra* note 12.

133. *See Action 5 Report*, *supra* note 24.

134. *See* David D. Stewart, *"Value Creation" Understanding Key to Transfer Pricing's Future*, 2015 Tax Notes Today 142–4 (July 24, 2015).

135. Michael Devereaux and John Vella of Oxford have pointed out that that assumption, which drives the 15-item BEPS Action Plan, would impose a new economic substance requirement over the existing international tax system. Devereaux & Vella, *supra* note 99, at 466.

mandates assessing corporate income tax in the location where there is the greatest number of employees, less developed countries where more people are employed in routine tasks might be allocated a greater share of corporate profits. If taxes should be allocated where value (intellectual property; knowledge) is created, one may reach different conclusions. For example, if the value of a company such as Apple is derived primarily from the activities of designers and engineers working in Cupertino, California, a greater portion of its income tax obligations might be due to the jurisdiction where the ideas originate. Such a system may encourage innovation, but it may not reach the result that many participants in the BEPS project intended. And the language used by the OECD in BEPS is sufficiently vague so as to allow all countries to read into it what they wish.

III. Poor Outcomes

This section describes just a few of the poor outcomes that followed from the unresolved issues at the heart of the BEPS undertaking.

A. Minimum Standards and Lack Thereof

The BEPS Action Plan included 15 action items, and the OECD published 15 reports (albeit that some of the reports on transfer pricing were consolidated) on its October 2015 target date. But only four of these items achieved sufficient consensus to enable the OECD to label them "minimum standards" that all participants would commit to. The "minimum standards" label disguises the fact that for most of the remaining action items the participants failed to agree to a uniform approach.[136]

The four minimum standards include: (1) a treaty anti-abuse rule; (2) transfer pricing documentation in the form of country-by-country

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136. The OECD has explained that in other areas (such as recommendations on hybrid mismatch arrangements and best practices on interest deductibility), "countries and jurisdictions have agreed [on] a general tax policy direction," and that "domestic rules are expected to converge through the implementation of the agreed common approaches." *OECD Inclusive Framework*, *supra* note 110, at 9; *see also Deciphering BEPS: What Do the Categories Mean?*, EY Tax Insights, http://taxinsights.ey.com/archive/archive-articles/deciphering-beps-what-do-the-categories-mean.aspx (last visited Sept. 27, 2017).

reporting; (3) rules against harmful tax practices, including standards for preferential regimes (patent boxes) and a requirement for automatic exchange of tax rulings; and (4) minimum standards for improving dispute resolution. Even within these minimum standards, there is a lot of room for different approaches to implementation; for example, not all countries could agree on a single treaty anti-abuse rule. (Specifically, the United States refused to commit to a principal purpose test, the anti-abuse rule of choice for most other countries.) The United States continues to adhere to the approach it has been utilizing in its treaties for the last several decades, the limitation on benefits test—a highly technical test that requires rigorous analysis of ownership facts for tested taxpayers. The principal purpose test, in contrast, provides tax administrators significant flexibility for determining when a taxpayer's behavior violates the "purpose of the treaty." The challenges inherent in a vague standard—one for which there is limited international guidance and less local country law—are exacerbated because the commentary provided in the BEPS final reports has not been incorporated into the multilateral instrument. This instrument, which is designed to allow countries to incorporate BEPS changes into existing treaties with a single document (rather than having to go through renegotiation of multiple treaties), is not being incorporated into existing treaties but, as OECD officials have described, hovers on top of them.[137]

In the case of some of the other minimum standards, countries are disputing their implementation, despite having committed to them. France, for example, has a patent box that is clearly in violation of the new standards agreed to in Action 5. Nevertheless, France is refusing to change the terms of its patent box, arguing it should qualify under the

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137. *See* OECD, *Explanatory Statement to the Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting*, at 1–7 (Nov. 24, 2016) https://www.oecd.org/tax/treaties/explanatory-statement-multilateral-convention-to-implement-tax-treaty-related-measures-to-prevent-BEPS.pdf. For an outline of a number of the concerns with the approach to revising bilateral tax treaties being adopted by the multilateral instrument, see comments to the discussion draft on the multilateral instrument submitted by the International Tax Group in OECD, *Comments Received on Public Discussion Draft: BEPS Action 15*, at 154–62 (June 30, 2016), http://www.oecd.org/ctp/treaties/public-comments-received-discussion-draft-Development-of-MLI-to-Implement-Tax-Treaty-related-BEPS-Measures.pdf.

new standards because its preferential rate for intellectual property income is higher than other countries' normal statutory rates.[138]

The requirement for transfer pricing documentation, including country-by-country reporting, is one of the most identifiable successes of the BEPS project. Many countries have eagerly adopted the reporting rules,[139] while taxpayers are scrutinizing structures to be able to tell the right story on a reporting form. In some cases, they are modifying structures in order to be able to tell a more compelling story. If the goal was to modify taxpayer behavior, the country-by-country reporting requirement may be accomplishing that goal.

Meanwhile, for the remaining substantive action items, the reports produced not minimum standards but either recommendations or descriptions of best practices. The flaws with the revisions to the transfer pricing guidelines undertaken as part of the BEPS project are described below, and the irony of failure to agree on rules for the digital economy are discussed in the next section. The remaining action items—in reality, paper fixes dressed up as recommendations and surveys of practice—did nothing to address the structural tensions in the international tax system that gave rise to the BEPS project to begin with. To the contrary, the failure to adequately patch the cracks has allowed deeper fissures to develop.[140]

B. U.S. Nonparticipation

The United States is often assigned a large share of the responsibility for multinationals' tax planning activities that eventually prompted the OECD to undertake the BEPS project. A confluence of characteristics of the U.S. tax system are blamed, including a singularly high U.S. corporate tax rate; its worldwide system of taxation, which operates to

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138. *See* Ryan Finley, *Germany Passes Anti-Patent-Box Law as Neighbors Keep Pre-BEPS Regimes*, 2017 Worldwide Tax Daily 16–2 (Jan. 26, 2017).

139. *See BEPS Action 13: Country Implementation Summary*, KPMG, http://www.kpmg-institutes.com/content/dam/kpmg/taxwatch/pdf/2017/beps-action-13-country-implementation-summary.pdf (last updated Sept. 19, 2017).

140. *See* David Ernick, *Can the OECD Remain an International Tax Standard-Setting Organization*?, 45 Tax Mgmt. Int'l J. 745 (2016).

discourage repatriation of overseas profits and creates incentives to reduce foreign taxes on those earnings; accounting rules that generally permit the deferral of the accounting charge for U.S. tax on those earnings; and lax CFC rules that facilitate cross-border planning and foreign base erosion. One significant impetus for the BEPS project was to force the United States to modify these incentives and thereby prompt a change in U.S. companies' behavior. But those efforts seem to have failed, largely due to growing recognition in the United States that the BEPS project was adverse to its interests.

For example, poor enforcement of U.S. CFC rules is partly due to a set of rules that allows U.S. taxpayers to disregard the separate tax treatment of many foreign entities.[141] Known as the "check-the-box" rules (because taxpayers can elect treatment as a corporation or disregarded entity by checking the box on a U.S. tax form),[142] these rules are often blamed for inappropriately perpetuating the use of foreign base-eroding techniques by U.S. multinationals.[143] But the political reality is that the check-the-box rules permit the U.S. Congress to subsidize U.S. multinationals without the political cost of having to lower the corporate tax rate. U.S. legislators have a vested interest in preserving a system that allows for foreign base eroding by U.S. multinationals, which in turn allows them to keep their foreign tax rates low, to the ultimate benefit of the U.S. Treasury.

The strong interest that congressional lawmakers, at the insistence of their corporate constituents, have in maintaining the check-the-box rules has been made abundantly clear to multiple administrations. When the Clinton administration tried to shut down these rules administratively in 1998, it received a harsh rebuke from Congress and withdrew the proposal. And when President Obama attempted to introduce plans to overturn the rules in the 2009 budget, the proposal was also quickly

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141. *See* Paul Oosterhuis, *The Evolution of U.S. International Tax Policy: What Would Larry Say*?, 112 Tax Notes 87 (July 3, 2006).

142. Reg. § 301.7701–1 to–3; IRS Form 8832 (2013), https://www.irs.gov/pub/irs-pdf/f8832.pdf.

143. *See* Kleinbard, *Stateless Income*, *supra* note 3, at 720 n.36 (discussing Lawrence Lokken, *Whatever Happened to Subpart F? U.S. CFC Legislation After the Check-the-Box Regulations*, 7 Fla. Tax Rev. 185 [2005]); Stephanie Soong Johnston, *Politics Shouldn't Steer BEPS Implementation Policy, Stack Says*, 81 Tax Notes Int'l 929 (Mar. 14, 2016).

killed.[144] U.S. legislators have every reason to continue supporting the check-the-box system, rather than coordinating with other countries on rules that would penalize hybrid entities, because the system benefits U.S. multinational enterprises and ultimately the U.S. Treasury (by virtue of the fact that the United States provides a dollar for dollar offset against U.S. taxes for foreign taxes paid in the form of the foreign tax credit).

The same political dynamics at play in U.S. debates over reform of the check-the-box rules were evident in the U.S. approach to BEPS. Although the U.S. Treasury was originally an eager participant in the project, it soon came to see the goals of the BEPS project as contrary to U.S. economic interests and the fiscal health of U.S. companies.[145] The evolving U.S. perspective was evident in a speech given by Robert Stack, U.S. Deputy Assistant Treasury Secretary for International Tax Policy during the time period in which BEPS went from an idea to fruition. In his remarks, Stack noted that "many countries viewed BEPS as a way to increase their own tax bases, potentially at the expense of the U.S. tax base."[146] The view that the project impinged on U.S. sovereignty and ran counter to U.S. economic interests was even more strongly expressed in Congress.[147] At the same time, a series of administrations and Congress

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144. Kevin Drawbaugh & Andy Sullivan, *How Treasury's Tax Loophole Mistake Saves Companies Billions Each Year*, Reuters (May 30, 2013, 8:04 PM), http://www.reuters.com/article/us-usa-tax-checkthebox-insight-idUSBRE94T17K20130531.

145. The U.S. Treasury initially was a strong supporter of the BEPS project, the broad principles of which were generally consistent with rhetoric President Obama used in the 2012 election campaign, when he repeatedly insisted on the need to ensure that corporations pay their fair share of taxes. *See* Mindy Herzfeld, *News Analysis: The U.S. Treasury and the BEPS Mess*, 78 Tax Notes Int'l 1067 (Jun. 22, 2015).

146. Quoted in Alexander Lewis, *U.S. Using BEPS Project to Safeguard Tax Base, Stack Says*, 2016 Tax Notes Today 94–7 (May 16, 2016).

147. *See International Tax: OECD BEPS and EU State Aid*: *Hearing Before the S. Comm. on Finance*, 114th Cong. 1–3 (2015), https://www.finance.senate.gov/chairmans-news/hatch-statement-at-finance-hearing-on-oecd-beps-reports [hereinafter *Hatch Statement*] (statement of Senator Orrin G. Hatch, S. Fin. Comm. Chairman); Letter from Orrin G. Hatch, Chairman, S. Fin. Comm., & Paul D. Ryan, Chairman, H. Ways & Mean Comm., to Jacob Lew, Treas. Sec'y (Aug. 27, 2015), https://waysandmeans.house.gov/wp-content/

have been hampered by a failure to develop a coherent set of international tax policy goals.

Congressional views were based on the strong negative reactions of the business community to the BEPS project as well as ideological opposition to the OECD rulemaking power generally. Right-leaning media outlets strongly criticized the U.S. commitment to the BEPS project, highlighting the risks of the information exchange required by the transfer pricing documentation requirements (country-by-country reporting), arguing:

> The OECD is demanding a complete rewrite of American tax policy without the authorization of Congress. This constitutional end run is being worked out with officials from Obama's Treasury Department, who are quietly negotiating and making informal agreements for the United States that Obama will then recognize as "executive actions," with the full force of law.[148]

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uploads/2015/08/Letter-to-Secretary-Lew-on-BEPS.pdf (stating that "the benefits to the U.S. government, businesses and workers from providing sensitive information in the [country-by-country] reports . . . is unclear, at best"). Consider also the June 9, 2015, letter to Treasury Secretary Lew from Orrin Hatch and Paul Ryan expressing concerns about "several other proposals of the BEPS project, including, among others, [and] modifying the permanent establishment (PE) rules, using subjective general anti-abuse rules (GAAR) in tax treaties." Letter from Orrin G. Hatch, Chairman, S. Fin. Comm., & Paul D. Ryan, Chairman, H. Ways & Mean Comm., to Jacob Lew, Treas. Sec'y (Jun. 9, 2015), http://waysandmeans.house.gov/wp-content/uploads/2015/08/Hatch-Ryan-Call-on-Treasury-to-Engage-Congress-on-OECD-International-Tax-Project.pdf [hereinafter Hatch & Ryan June 2015 Letter].

148. Neil McCabe, *Will This Global Bureaucracy Get U.S. Tax Data?*, WorldNetDaily (May 7, 2015, 7:15 PM), http://mobile.wnd.com/2015/05/will-this-global-bureaucracy-get-u-s-tax-data/. Writing on the website Human Events, Brian McNicoll similarly denounced what he called the "massive and unprecedented gathering of information on U.S. corporations by the IRS" for the purpose of enabling "foreign governments to rummage around in the books of American corporations to determine the 'fair share' they should pay in this new global tax scheme." Brian McNicoll, *Obama Advocates European Ideas on Taxes*, Human Events (May 8, 2015, 9:36 AM), http://humanevents.com/2015/05/08/obama-advocates-european-ideas-on-taxes/.

Such criticism benefited from a receptive ear among congressional Republicans in particular and played out in strong congressional opposition to the Treasury's agreement to the OECD standard on country-by-country reporting.[149] It was not difficult for conservative activists and U.S. business representatives to make the case that OECD proposals to require more information reporting from U.S. companies were not in the best interests of American taxpayers. Many members of Congress are not eager to support new rules that could result in U.S. companies being subject to greater foreign taxes, while limiting the United States' ability to tax their profits.[150] Ultimately, though, congressional opposition to country-by-country reporting requirements was muted due to business support for U.S. involvement in the information exchange process.

In general, the BEPS project proved a useful target for Congress to voice its disapproval of Treasury's commitments to international organizations to adopt specific international tax rules, in conflict with the congressional tax-writing prerogative.[151] According to Senator Hatch, Chairman of the Senate Finance Committee, the U.S. Treasury's failure to involve Congress in the negotiation of international tax rules ran counter to constitutional principles.[152]

In the end, the United States agreed to adopt rules that constituted part of the "minimum standard" only in those areas where it already had rules in place, such as a treaty anti-abuse rule (in the U.S. case, the limitation on benefits provision); where it saw benefits for itself

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149. *See* Hatch & Ryan June 2015 Letter, *supra* note 147. Such critiques of international rulemaking bodies are not unique to the OECD and the BEPS project. *See* Barney Jopson & Caroline Binham, *Republicans Attack New Global Insurance Rules*, Fin. Times (Apr. 28, 2015), https://www.ft.com/content/b1229cb8-edc6-11e4-90d2-00144feab7de.

150. *See* Mindy Herzfeld, *News Analysis: Making Bets on CbC Reporting*, 78 Tax Notes Int'l 595 (May 18, 2015).

151. In the first congressional hearing on BEPS, Hatch issued a statement noting that he had "urged the Obama administration to both acknowledge the limits of their authority under the law and to cooperate with Congress on any and all efforts to implement the recommendations." He further stated, "while the U.S. was a party to the BEPS negotiations, Congress had neither a seat at the negotiating table nor a meaningful opportunity to weigh in with the administration on the substance of the proposals." *Hatch Statement*, *supra* note 147, at 2.

152. *Id.*

or its taxpayers (such as with respect to improved mutual agreement procedures); or where the rule did not directly impact U.S. tax laws (such as the Action 5 rules regarding harmful tax regimes). With respect to some action items, such as Action 7 concerning the PE standard, the United States has been noncommittal. For other action items, such as the Action 3 report on best practices for CFC rules, the United States has taken the position that it satisfies best practices. The most significant exception to the United States generally being able to prevent consensus on standards that it opposed was the transfer pricing documentation requirements of Action 13.

Not only has the United States not—and seems unlikely in the future to—make any additional changes to its tax rules and agreements specifically to accommodate BEPS consensus agreements, the BEPS project and initiatives like it may have been counterproductive in terms of getting the United States to change its rules. The United States is now in the midst of a project of substantially revising the U.S. corporate tax rules in a way that could negatively impact many other countries.[153] Instead of being upset about U.S. tax rules that facilitated multinationals' profit shifting, other countries may soon have much greater concerns if the United States adopts a more aggressively competitive tax system, with a potential unilateral rewrite of international tax rules that could tilt the benefits of the international tax system more heavily in favor of the United States.

C. Digital Economy

Crafting new rules to address perceived failures of the existing laws to accommodate changes resulting from the digital economy was a significant impetus for the BEPS project. But that part of the project simply

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153. In September 2017, the White House published a tax reform document representing the policy goals of the White House, Senate, and House leadership. The plan includes proposals to shift the U.S. to a territorial system of taxation and impose a minimum tax on foreign earnings. *See* Unified Framework for Fixing our Broken Tax Code (Sept. 27, 2017), https://www.treasury.gov/press-center/press-releases/Documents/Tax-Framework.pdf. In October, the Senate Finance committee held a hearing in which witnesses testified as to the need for the U.S. tax system to focus more closely on U.S. base erosion practices of foreign multinationals. *Hearing on International Tax Reform*, *supra* note 102.

failed to progress in a significant fashion. France and the United States were co-heads of Action 1, which addressed the digital economy, and from the beginning, the United States was skeptical of the initiative.[154] In the end, the United States staunchly refused to agree to rules that it viewed as adverse to U.S. technology companies.[155]

But undertaking a big project with fanfare and then failing to agree on a way forward isn't a favorable outcome for anyone. The most likely result is that countries will simply act on their own, with each adopting a different path. India provides one example of what might be expected going forward in this regard. Instead of waiting for the next version of a report on the digital economy—due out in 2018—India has proceeded to adopt one of the approaches to tackling the digital economy concerns that was not recommended by the final Action 1 report. Effective in June 2016, India enacted an equalization levy, a tax described but not recommended in the report.[156] The new six percent withholding tax is required to be withheld from amounts paid to non-residents who do not have a PE in India, for specified services. Indian residents conducting business or non-residents with a PE in India must withhold the equalization levy. The specified services include online advertisement, any provision for digital advertising space, or any other facility or service for the purpose of online advertisement. And in response to the OECD's inaction, the European Union in late 2017 launched a separate initiative to develop short-term solutions for taxing the digital economy, including a proposal for a turnover tax.[157]

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154. *See* Margaret Burow et al., *Stack Provides Insights on BEPS Reports, Outlines Next Steps*, 75 Tax Notes Int'l 1087 (Sept. 29, 2014). Robert Stack, then the U.S. Deputy Assistant Treasury Secretary for International Tax Policy, noted that "the U.S. contingent had deep concerns at the beginning of the project over some countries' efforts to develop special rules for the digital economy." Kristen A. Parillo, *Robert Stack—BEPS and the United States*, 76 Tax Notes Int'l 1055 (Dec. 22, 2014).

155. *See* Finley, *supra* note 93.

156. *See* Finance Act, No. 28 of 2016, ch. VIII (India), http://www.cbec.gov.in/resources//htdocs-cbec/fin-act2016.pdf;jsessionid=93047635963AB1D6611D5776E161A45B.

157. *See* Vice-President Dombrovskis on the Communication on A Fair and Efficient Tax System in the European Union for the Digital Single Market, SPEECH/17/3402 (Sept. 21, 2017), http://europa.eu/rapid/press-release_SPEECH-17-3402_en.htm.

D. Vague Rules

For many of the BEPS action items, the final reports, agreed to by consensus, disguised substantive disagreements between the parties. Such disagreements were manifested in vague language intended to minimize opposition. Two examples of such vague outcomes are the revised transfer pricing guidelines and the new PE standard.

1. Transfer Pricing Guidelines—Deliberate Incoherence?

Intended to satisfy all participants, the final BEPS reports were so watered down as to be meaningless, and so vague that they could be interpreted by every country's tax administrators as they wished. Such vagueness is particularly evident, and particularly acute, in the new transfer pricing guidelines (Actions 8–10).[158] Those guidelines purport to apply the arm's length standard, which requires pricing of transactions among members of multinational groups to be set in accordance with the behavior of parties acting at arm's length. But rigorous application of that standard has resulted in companies being able to shift profits to lower taxed jurisdictions. As a consequence, in the course of the BEPS project, countries demanded revision to the arm's length standard. Unable to draft such revisions while remaining within the constraints of the economic theory on which the guidelines rested, yet not willing to abandon the standard (nothing better having been presented), the OECD was forced to produce anti-abuse or substance-over-form rules that continued to profess adherence to the arm's length standard.[159] The resulting rules leave themselves open to multiple interpretations by both taxpayers and administrators, opening the door to even more aggressive planning and numerous cross-border disputes, as well as an abandonment of the rule of law by tax administrators.[160] They could also prompt companies to move jobs and business operations out of high-tax

158. *See BEPS Transfer Pricing Report*, *supra* note 23.

159. *See* Ryan Finley, *Forget 'DEMPE' Label, McDonald Says*, 86 Tax Notes Int'l 38 (Apr. 3, 2017).

160. *See* David Ernick, *New OECD Rules Seek Broad Expansion of Tax Authority Power to Disregard Transactions*, 45 Tax Mgmt. Int'l J. 90 (Feb. 12, 2016); Philip D. Morrison, *BEPS 2015 Final Report Regarding Transfer Pricing of Intangibles*, 45 Tax Mgmt. Int'l J. 224 (April 8, 2016).

jurisdictions and into low-taxed ones, not the result desired by those countries pressing for changes.

The rules' incoherence was demonstrated on numerous occasions when current or former OECD and government officials tried to explain them at various tax conferences. Such officials often made two contrary claims regarding the changes made to the transfer pricing guidelines through the BEPS project. One was that the changes did not represent substantive modifications to the guidelines but merely introduced new rigor into their application. At the same time, they argued that the rules represented a significant change because they provided for profit sharing between and among capital investors and those who controlled risk. The latter explanation is hard to reconcile with the arm's-length principle.[161] OECD officials have referred to the lack of integrity for economic analysis purposes as deliberate, calling it a "pragmatic fudge."[162]

Many of the revisions to the OECD transfer pricing guidelines address taxpayers' contractual allocation of risks and the allocation of profits to risks.[163] Taxpayers' ability to shift profits between jurisdictions rankled many countries, and changes to the guidelines were intended to address situations in which allocation of profits to risks did not correspond with activities of the entity being allocated the risk. To tackle tax planning involving allocation of risks to low-tax jurisdictions, sometimes without any significant change in business operations, the guidelines put new emphasis on control over risk. The guidelines say that risks contractually assumed by a party that cannot exercise meaningful control over them will not be entitled to the higher return normally associated with risk.[164]

Under the arm's length standard, an entity's functions, assets, and risks have generally formed the basis for the analysis of how much profit it should be allocated. The revised guidelines altered that calculus by placing increased emphasis on risk. They introduce a complex

161. *See* Ryan Finley, *BEPS Report on Transfer Pricing 'Could Have Been Worse,' Hickman Says*, 82 Tax Notes Int'l 1050 (June 13, 2016).

162. *See* Mindy Herzfeld, *News Analysis: Will the OECD's 'Pragmatic Fudge' Save Transfer Pricing?*, 83 Tax Notes Int'l 360 (Aug. 1, 2016).

163. *See* Wolfgang Schön, *International Taxation of Risk* 2–5 (Max Planck Inst. for Tax Law & Pub. Fin., Working Paper No. 2014-03, 2014), https://ssrn.com/abstract=2402612.

164. *See BEPS Transfer Pricing Report*, *supra* note 23, at 21–35.

six-step process for analyzing risk. But even disregarding the complexities, the new standards are problematic. There are significant discrepancies between the methodology required for analyzing the appropriate return to risk and the economic principles incorporated into the arm's length standard.[165] Because assigning the residual return to the controller of risk rather than the investor is inconsistent with economic principles, which generally assign residual returns to capital, the only way to really make sense of the new guidance is to view it as an anti-abuse rule. But the lack of coherent economic theory in the new guidelines leaves a void for taxpayers, and their advisors, who need to apply these rules to real fact situations in order to prepare tax returns in different jurisdictions.

It's not just practitioners that face a problem interpreting the new guidance. The revised guidelines seem unlikely to provide the results that their advocates hoped for. Policy officials generally pointed to two types of egregious structures in justifying the need for changes to the transfer pricing guidelines: the cash box and supply chain restructuring.[166] The cash box, most closely associated with U.S. pharmaceutical and technology groups, relies on the U.S. transfer pricing regulations to justify an arrangement in which a U.S. company funds development of intellectual property through a subsidiary resident in a low-tax jurisdiction, such as Bermuda. Cost-sharing arrangements can permit a large share of the profits from the developed intangible to be allocated to the funding entity. If undertaken properly, the group's Bermuda affiliate earns significant returns from royalties paid by affiliates worldwide for the right to use the intangible in production or in distributing the product. The cash builds up in Bermuda because of the disincentives to repatriate it to the United States.

Supply chain restructuring can be useful even to companies without the potential for high-growth intellectual property. Under a principal company structure, the group's supply chain is realigned so that key decision-making is centralized and top personnel in manufacturing, logistics, or sales are located in a low-tax jurisdiction. Operations in high-tax jurisdictions are then restructured to become low-risk manufacturers

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165. *See* Jens Wittendorff, *At Arm's Length: BEPS Actions 8–10: Birth of a New Arm's-Length Principle*, 81 Tax Notes Int'l 331, 332–44 (Jan. 25, 2016).

166. *See* David D. Stewart, *OECD to Address Cash Boxes Without Special Guidance*, 148 Tax Notes 172 (July 13, 2015).

or distributors, earning lower profits. Revenue administrators feel that taxpayers are abusing the system when they see the same number of personnel and the same types of activities going on pre- and post-restructuring, but a reduced tax base.

But the new focus on control of risk may not change the profit allocations in a way beneficial to those countries that thought they would benefit. Instead, allocating a greater return to risk might dictate that the United States is entitled to an even larger share of multinationals' profits than under current rules.[167] For many high-tech companies, management decisions—that is, the control of risk—take place in this country. Reallocating profits to the United States is probably not the result many other countries had in mind. And unless the United States enacts a minimum tax or changes its controlled foreign corporation rules to assert tax jurisdiction over those profits, the profits will remain trapped, potentially subject to very low rates of tax. For supply chain restructurings, the rules also could have results opposite of what some countries intended. An increased focus on control of risk means that companies might move ten people to the principal company rather than three, leading to a migration of even more high-value functions from high- to low-tax jurisdictions. The OECD's new rules may therefore be paving the way to even greater transfers of assets to tax havens or, alternatively, encourage countries to enact new, preferential regimes to attract a minimum amount of substance.[168] Tax administrators writing anti-abuse rules don't always have the foresight to see the potential negative impact of law changes.[169]

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167. Some recent economic analyses support the view that a greater share of multinationals' profits belongs in the U.S., from an economic measurement and valued added perspective. *See Measuring the Impact*, *supra* note 91; Fatih Guvenen et al., *Offshore Profit Shifting and Domestic Productivity Measurement* (Nat'l Bureau of Econ. Research, Working Paper No. 23324, 2017), http://www.nber.org/papers/w23324.

168. *See EY Global Tax Alert: Israel Proposes New Innovation Box Regime to Attract IP Investment*, EY (July 19, 2016), http://www.ey.com/gl/en/services/tax/international-tax/alert—israel-proposes-new-innovation-box-regime-to-attract-ip-investment.

169. The consequences of enactment in the United States of anti-inversion rules—under which inversions have transitioned from paper transactions to substantive outbound mergers—is illustrative of the sometimes perverse incentives created by anti-abuse rules. *See* Mindy Herzfeld, *News*

2. The Permanent Establishment Standard

Revisions to the PE standard—an area of the law that has been in place for decades—were also a significant focus of the BEPS work. The BEPS project was supposed to address specific perceived abuses in the PE standard. The BEPS Action Plan listed a number of these abuses, including what it described as artificial avoidance of PE status through commissionaire arrangements and similar strategies; fragmentation of a cohesive operating business into several small operations in order to argue that each part is merely engaged in preparatory or auxiliary activities (such activities are subject to an exception from the general standard); and the practice of splitting-up contracts between closely related enterprises.[170] Business fought back against the broadening of the PE standards, arguing that changes to the standard could negatively impact cross-border commerce. For example, the Business and Investment Advisory Committee to the OECD (BIAC) said that despite OECD assertions that the standard wasn't changing dramatically, "[b]road PE rules, combined with a lack of clear guidance on profit attribution, may encourage some countries to assert that the international standards have been fundamentally changed."[171] According to BIAC, this concern was "greatly increased because the proposals include a number of new and (to date) undefined terms and appear to substantially lower the existing threshold (compared to the current OECD model)." Other business groups, along with the U.S. Treasury, tried to make the case that new rules for determining when a PE existed were irrelevant or meaningless without additional work on how to attribute profits to newly formed PEs. But even though the OECD was unable to reach consensus on attribution of profits as part of finalizing its BEPS work, it went ahead with recommended changes to the PE standard.[172]

Analysis: Have Treasury's Anti-Inversion Rules Backfired?, 149 Tax Notes 1214 (Dec. 7, 2015).

170. *See Action 7 Report*, *supra* note 21.

171. Letter from William Morris, Chair, BIAC Tax Comm., to Marlies de Ruiter, Head, Tax Treaties, Transfer Pricing & Fin. Transactions Div., OECD, at 4 (June 12, 2015), http://biac.org/wp-content/uploads/2015/01/Final-BIAC-Comments-Action-71.pdf.

172. The United States has said it would not commit to the revised PE standards without the final guidance on the attribution of profits. *See* Ryan

Even before the BEPS changes, determination of PE status was already one of the most subjective and fact-driven areas of international tax law. For businesses investing in a new location or trying to increase sales in a new jurisdiction, the precise parameters of PE guidelines is generally an afterthought. For new businesses expanding abroad at a rapid pace, they often discover—too late, with numerous adverse consequences—that a PE, along with all the compliance obligations that entails, was created through the actions of an individual employee or agent whose activities were little known to central management. Fact-driven analysis means that assessment of a PE is an easy way for local revenue agents to assess additional taxes on multinationals doing business in their jurisdictions. Quantification of PE risk was already challenging for financial statement and valuation purposes. New broadened standards that lack agreed-upon definitions and interpretation will exacerbate this situation.

The final BEPS reports significantly scaled back the proposed changes to the PE standards, and business celebrated those victories.[173] But it's not clear who has the last word here. For one, much of the authority that business needs to rely on for the tightened standards (relative to the proposals) is contained in the commentary to the Action 7 report. But the commentary has not been incorporated as official commentary to the multilateral instrument, potentially meaning that the commentary is not authoritative in interpreting the new treaty language. In addition, the reluctance of many countries to adopt the language finally agreed on in BEPS is fully evident at the United Nations, whose new model treaty and commentary goes back to, and in some cases expands on, the proposed BEPS language.[174] Tighter treaty language and helpful commentary may not unify the interpretation of new PE standards if the backstory is that countries agreed to language in the BEPS project with no intention of conforming audit practices to the agreed-upon language. All of this seems likely to play out in audit in the years ahead.

In addition to ambiguities created by the agreed-upon treaty language, there is another movement for broadened PE standards occurring

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Finley, *U.S. Taking Cautious Approach to Adoption of New PE Standard*, 2016 Tax News Today 89–19 (May 9, 2016).

173. *See* Richard Collier, *More Guidance Needed on PE Threshold Issues*, 80 Tax Notes Int'l 249 (Oct. 19, 2015).

174. U.N. Model Double Taxation Convention Between Developed and Developing Countries, 2017 (forthcoming).

in parallel. Some countries—which either thought the agreed-upon language was insufficiently broad, or thought it would take too long to reach agreement—have proceeded unilaterally, adopting new laws to broaden the traditional PE definition even further. The U.K. government in 2015 enacted the diverted profits tax, which radically redefines the concept of a PE in situations where a foreign company has allegedly artificially avoided having a PE in the United Kingdom; or when a U.K. company, or a foreign company with a U.K. PE, creates a tax advantage by using entities or transactions that lack economic substance.[175] Australia has subsequently introduced its own version of the diverted profits tax in two separate provisions. New Zealand has followed with a similar proposal, although it eventually cut it back.[176]

In other words, the revised PE rules have done little to achieve a new universal standard of PE. The United States—the world's largest economy—has refused to agree to the new standard. For other countries that have stated their willingness to revise their treaties to include the new standard, the ambiguous nature of the BEPS commentary means that there will be a multitude of interpretive questions. Ambivalence over the new standard can be seen in the limited adoption in the multilateral instrument signed by many countries in 2017.[177] For many other countries, agreement to the language appears to be but lip service, with an intention to adopt even broader standards—either in treaties or on audit—in the works. And those taking the most radical step have essentially made a decision to deviate from agreed-upon language in situations they view as abusive.

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175. *See* Finance Act 2015, pt. 3 (U.K.), http://www.legislation.gov.uk/ukpga/2015/11/part/3/enacted; HM Rev. & Customs & HM Treas., Diverted Profits Tax: Consultation Draft 3 (2014) (U.K.), https://www.gov.uk/government/uploads/system/uploads/attachment_data/file/385741/Diverted_Profits_Tax.pdf; HM Rev. & Customs & HM Treas., Explanatory Notes: Finance Act 2015*,* at § 78 (2015) (U.K.), http://www.legislation.gov.uk/ukpga/2015/11/notes/division/1/78.

176. New Zealand Inland Rev., *Base Erosion & Profit Shifting: A Summary of the Key Policy Decisions* (Aug. 2017), https://taxpolicy.ird.govt.nz/publications/2017-other-beps-decisions/overview; Shinasa Wasimi et al., *Diverted Profits Tax: U.K., Australian, and New Zealand Approaches*, 2017 Worldwide Tax Daily 153–12, 2–3 (Aug. 10, 2017).

177. Mindy Herzfeld, *News Analysis: The Multilateral Instrument and Permanent Establishments*, 86 Tax Notes Int'l 1029 (June 19, 2017).

IV. Conclusion

Without a reexamination of underlying principles to formulate goals for an international tax system that take into account both global inequalities and the benefits countries obtain from tax competition, it will be difficult for any coordination effort to make substantive progress that could achieve widespread acceptance in fixing the system.[178] The BEPS project—which ostensibly was not about fixing the system, but only about addressing certain perceived abuses—generated unsatisfactory outcomes because different countries had varying objectives. While some (such as the United States) resisted most changes, others viewed the project as a means of addressing the system's larger perceived inequities. The project's outcomes—which failed to address these larger concerns—produced vague rules that further weakened the system due to the depth of the lack of underlying consensus. Unilateral action that places even greater pressure on the system was a result.

While the international tax system is broken, there is no ready mechanism to fix it, because the ability of a small group of like-minded countries to coordinate global rules does not exist today as it did in the early twentieth century. Attempts at coordination led by developed countries—of which BEPS represents the most obvious example—are doomed to be unsuccessful because they lack full participation from non-OECD global economic players, are based on incoherent principles, and fail to take account of strong nationalist interests. The BEPS project was inherently problematic precisely because it masked deep underlying differences between countries in the interest of claiming success on achieving consensus. In attempting to rewrite international tax rules, doing a little can be worse than doing nothing, if the result is vague rules that mask fundamental disagreements and weaken the rule of law. Moving forward on a coordinated basis will require a reexamination of fundamental principle and broad agreement on such principles.

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178. *See* David A. Weisbach, *The Use of Neutralities in International Tax Policy* 3 (Coase-Sandor Inst. for Law & Economics, Working Paper No. 697, 2014), http://chicagounbound.uchicago.edu/law_and_economics/714/ (citing Graetz, *supra* note 3, and arguing that the best way to make international tax policy is to first develop the social goal and then to determine the best set of trade-offs for achieving it given the tools and information available); *see also* Cui, *supra* note 30, at 266.