Brooklyn Journal of International Law

Volume 41
Issue 3 *SYMPOSIUM: Reconsidering the Tax Treaty*

Article 3

2016

Treaties in the Aftermath of BEPS

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Available at: http://brooklynworks.brooklaw.edu/bjil/vol41/iss3/3

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TREATIES IN THE AFTERMATH OF BEPS

Yariv Brauner[*]

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INTRODUCTION

Tax treaties are peculiar creatures. They are ubiquitous and familiar, standard and universal. Being among the most salient building blocks of international economic law, they have

an almost respectable façade. Yet, they are also elusive legal instruments and lack a consensus about their true nature and purpose. Tax professionals in some countries apply them on a daily basis, sometimes as a matter-of-fact, yet others rarely resort to them. Standard as they are, in some countries tax treaties provide the core applicable tax norms, whereas in other countries their effect on tax consequences is marginal.

Complex as they are, nonetheless, tax treaties seem to be very effective and popular. The network of over three thousand bilateral income tax treaties constructs a rather stable international tax regime that essentially dictates the tax treatment of a majority of the cross-border investments in the world.[1] Standard and universal in both substance and geographical coverage, and having been so for far more than half a decade, they provide the tax practice with comfort and familiarity that compensate for the occasional lack of clarity and finality.[2]

Such stability may, however, not last long. Globalization and technological changes have challenged the very basics of the regime, leaving it without a good solution for issues such as electronic commerce, derivative financial instruments, and transfer pricing, to name a few.[3] Further, geopolitical changes have challenged the dominance of the Organisation for Economic Co-operation and Development (OECD) and traditionally rich countries over the regime.[4] Corporations and other non-state organi-

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1. Reuven S. Avi-Yonah, *Commentary*, 53 TAX L. REV. 167, 169 (2000) (explaining that the international tax regime is constructed around the network of bilateral tax treaties, essentially all of which are modeled after the OECD Model Tax Convention). The original acknowledgment of the existence of such a regime was in Reuven S. Avi-Yonah's "The Structure of International Taxation: A Proposal for Simplification." Reuven S. Avi-Yonah, *The Structure of International Taxation: A Proposal for Simplification*, 74 TEX. L. REV. 1301, 1349 (1996).

2. *See, e.g.*, THE IMPACT OF THE OECD AND UN MODEL CONVENTIONS ON BILATERAL TAX TREATIES (Michael Lang et al. eds., 2012).

3. These pressures have culminated in the Base Erosion and Profit Shifting (BEPS) project and the acknowledgement of the necessity to reform the regime. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], ADDRESSING BASE EROSION AND PROFIT SHIFTING (2013).

4. *See generally* BRICS AND THE EMERGENCE OF INTERNATIONAL TAX COORDINATION (Yariv Brauner & Pasquale Pistone eds., 2015).

zations also grew in power, which required considerations of actors beyond the states. These changes coincided and put the future of tax treaties in jeopardy.

Out of this turmoil arose the Base Erosion and Profit Shifting (BEPS) project.[5] The project was triggered by public outrage over aggressive corporate tax planning and was fueled by the media exposure of such schemes, which mandated the reform of the international tax regime.[6] Tax treaties, as the building blocks of such a regime, were required to respond to the challenge and address their failure to do so before the political mandate.

This article argues that despite the fanfare around it,[7] the outcome of the BEPS project is unlikely to be dramatic, at least in the short-term. Beyond a period of increased legal uncertainty and perhaps an atmosphere of more aggressive enforcement by some countries,[8] one should anticipate little substantive change

5. *See* OECD, *supra* note 3; ORG. FOR ECON. CO-OPERATION & DEV. [OECD], ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING (2013); *BEPS 2015 Final Reports*, OECD.ORG, http://www.oecd.org/tax/beps-2015-final-reports.htm (last visited June 8, 2016).

6. Initially, the tax-planning schemes of the largest technology corporations—such as Apple, Microsoft, and Google—were exposed. *See* Charles Duhigg & David Kocieniewski, *How Apple Sidesteps Billions in Taxes*, N.Y. TIMES, Apr. 28, 2012, at A1; Jesse Drucker, *Google Revenues Sheltered in No-Tax Bermuda Soar to $10 Billion*, BLOOMBERG (Dec. 10, 2012, 12:01 AM), http://www.bloomberg.com/news/2012-12-10/google-revenues-sheltered-in-no-tax-bermuda-soar-to-10-billion.html; Richard Waters, *Microsoft's Foreign Tax Planning Under Scrutiny*, FIN. TIMES (June 7, 2011, 2:38 AM), http://on.ft.com/1Uee9GS. Soon thereafter, however, it became clear that the phenomenon was more widespread. Edward D. Kleinbard, *Through a Latte Darkly: Starbucks's Stateless Income Planning*, 139 TAX NOTES 1515, 1515 (2013).

7. For an example of such praise, see the OECD's press release at the closure of the project. *OECD Presents Outputs of OECD/G20 BEPS Project for Discussion at G20 Finance Ministers Meeting*, OECD.ORG (May 10, 2015), http://www.oecd.org/ctp/oecd-presents-outputs-of-oecd-g20-beps-project-for-discussion-at-g20-finance-ministers-meeting.htm; *see also* Lee A. Sheppard, *OECD Head Takes a BEPS Victory Lap*, 149 TAX NOTES 340, 340 (2015).

8. One could already observe this change in the audit environment. *See, e.g.*, *Spain - Response to BEPS*, KPMG (Oct. 24, 2015), https://home.kpmg.com/xx/en/home/insights/2015/10/spain-response-to-beps.html; C. DAVID SWENSON, PRICEWATERHOUSECOOPERS, GLOBAL TAX AUDITS AND DISPUTES: NEW FORCES ARE CONVERGING TO FORM SECOND WAVE, PWC (2013), http://www.pwc.com/gx/en/tax/publications/transfer-pricing/perspectives/assets/tpp-globaltaxauditsanddisputes.pdf; William Hoke, *Tax Directors Detail Unconventional Approaches to Transfer Pricing Audits*, 80 TAX

in tax treaties. The challenges to the dominance of the OECD and the richest countries in the world would likely be assuaged by marginal concessions, most or all of which do not affect tax treaties. Yet, this article sees a silver lining in the non-substantive, structural, and instrumental outcomes of the BEPS project. It argues that, even if unintended, these outcomes, including the multilateral instrument, the compact to intensify the use of arbitration, and the standardization of transfer-pricing reporting, will have the most meaningful impact on tax treaties, their content, and the future of the international tax regime.

Part I of the article begins with an exposure of the current state of the international tax regime and the unanswered challenges that threaten to destabilize it. Part II analyzes the place of the BEPS project in the evolution of the regime. Part III assesses the impact of BEPS on the future of tax treaties and the international tax regime. The article then concludes.

I. THE INTERNATIONAL TAX REGIME: CRYSTALLIZATION AND DISINTEGRATION

The current international tax regime is comprised of over three thousand bilateral tax treaties that govern the taxation of the large majority of cross-border business and investment.[9] These treaties are meaningfully standard. Scholars estimate that around 75 percent of the language of all tax treaties is taken from a single source: the OECD Model Tax Convention on Income and on Capital ("OECD Model").[10] The OECD Model dominates the current tax treaty law.[11]

The standardization of international tax law is not confined, however, to tax treaty law. Since (at least) the post-WWII period,

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NOTES INT'L 409, 409 (2015); Raymond Doherty, *Companies Fear BEPS "Tax Chaos,"* ECONOMIA (May 13, 2014), http://economia.icaew.com/news/may-2014/companies-fear-beps-tax-chaos.

9. *See* Avi-Yonah, *supra* note 1.

10. The OECD Model has been amended from time to time. *See* THE IMPACT OF THE OECD AND UN MODEL CONVENTIONS ON BILATERAL TAX TREATIES, *supra* note 2.

11. *Id.*

international tax laws of essentially all countries have significantly converged.[12] Such convergence occurred not only in income taxes, on which this article focuses, but also more generally in fiscal devices and policies.[13] Much of this convergence can be attributed to tax treaties and their standardization,[14] yet some of it relates to norms that are merely tangential or unrelated to treaty norms.[15]

Such standardization, however, has not amounted to much harmonization. An international tax regime has emerged but is based primarily on soft law.[16] The convergence has attracted some scholars to examine whether this regime has reached a customary international law status.[17] Such a conclusion, however, has not yet been reached and remains primarily a desirable goal for some. Numerous differences among tax laws still exist, many of which are difficult to rationalize.[18] Some of these differences have facilitated the type of aggressive corporate tax planning that triggered the launch of the BEPS project.[19] A fundamental insight of BEPS was that countries could not proceed to make completely independent tax policies because of the interdependence of their economies.[20] It is difficult for countries to act

12. *See* Yariv Brauner, *An International Tax Regime in Crystallization*, 56 TAX L. REV. 259, 266 (2003).

13. A more general review of this convergence is, however, beyond the scope of this article and will have to wait for another occasion.

14. The most salient example of this phenomenon is perhaps the almost universal use of the permanent establishment ("PE") concept for the taxation of business income of foreigners.

15. The almost universal convergence of source rules is one example of this phenomenon. *See* Brauner, *supra* note 12, at 278–82.

16. *See* Allison Christians, *Hard Law, Soft Law, and International Taxation*, 25 WISC. INT'L L.J. 325, 331 (2007); Diane Ring, *Who is Making International Tax Policy?: International Organizations as Power Players in a High Stakes World*, 33 FORDHAM INT'L L.J. 649, 652 (2010); Hugh J. Ault, *Reflections on the Role of the OECD in Developing International Tax Norms*, 34 BROOK. J. INT'L L. 757 (2009); Jose M. Calderón, *The OECD Transfer Pricing Guidelines as a Source of Tax Law: Is Globalization Reaching the Tax Law?*, 35 INTERTAX 4 (2007); Alberto Vega, *International Governance Through Soft Law: The Case of the OECD Transfer Pricing Guidelines* (TransState, Working Paper No. 163, 2012), http://hdl.handle.net/11858/00-001M-0000-000E-78E6-3.

17. *See* REUVEN S. AVI-YONAH, INTERNATIONAL TAX AS INTERNATIONAL LAW: AN ANALYSIS OF THE INTERNATIONAL TAX REGIME (2007).

18. *See generally* Brauner, *supra* note 12.

19. *See supra* text accompanying note 6.

20. *See* Yariv Brauner, *What the BEPS?*, 16 FLA. TAX REV. 55 (2014).

quickly on this insight and enhance coordination of their tax policies since, at its core, the international tax regime is designed to enhance competition, not cooperation among tax jurisdictions.

A. The Competition-Based International Tax Regime

The current international tax regime is firmly constructed around a competition framework. Obviously, it is not institutionalized;[21] it includes no strong supranational norms, if any; it does not have a mandatory dispute resolution device;[22] and, by design, legal action taken pursuant to the regime is decisively unilateral and not cooperative.[23] This should not be surprising since the world's strongest economic powers and enthusiasts of market theory, following the so-called "Washington Consensus," were instrumental in constructing the regime.[24] The international tax regime evolved with the apparent sole aim to perfect such competition rather than curb it. Unsurprisingly, it remained a soft legal regime with no established international forum or supranational and evolving body of law. Some reputable

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21. The international tax regime remains noninstitutional despite attempts to advocate such institutionalization. *See, e.g.*, Frances M. Horner, *Do We Need an International Tax Organization*, 24 TAX NOTES INT'L 179 (2001); Brauner, *supra* note 12, at 265–91.

22. Even the recommended mandatory arbitration procedures have not yet been included in the OECD Model. A renewed attempt to promote the idea by the BEPS project garnered support of only twenty developed states. *See infra* text accompanying note 31.

23. This is true even in the application of the transfer-pricing rules that regulate cross-border intra-firm transactions. Such transactions always concern at least two jurisdictions, yet the norm is for each jurisdiction to regulate the "transfer price" as it affects the income of "its" taxpayer, regardless of what the other jurisdiction does. Bilateral and multilateral rulings on these matters, known as advanced pricing agreements, seem natural in this context, yet they are rare.

24. The term "Washington Consensus" was coined by John Williamson in a 1989 summary of ten key development-advice items commonly shared by the Washington, D.C. institutions—the International Monetary Fund, World Bank, and U.S. Treasury Department. In its original context, it served as advice to Latin American countries following the 1980s crisis. *See* John Williamson, *What Washington Means by Policy Reform*, *in* LATIN AMERICAN READJUSTMENT: HOW MUCH HAS HAPPENED 7 (John Williamson ed., 1989). This advice later became the symbol of what is often called market fundamentalism. For a reflection on the evolution of the term and its symbolism, see AFTER THE WASHINGTON CONSENSUS: RESTARTING GROWTH AND REFORM IN LATIN AMERICA (Pedro-Pablo Kuczynski & John Williamson eds., 2003).

scholars have disputed the mere existence of the regime, or perhaps the utility of referring to it as such, based on its continuous and conspicuous "softness."[25]

Following this agenda, the academic analysis of the international tax regime has also been dominated by the perceived binary choice between competition and harmonization.[26] Since no one seriously wished for a global tax government, and surely no one believed that countries would agree to it, harmonization was generally rejected outright.[27] Consequently, the regime stuck to reliance on competition, primarily based on the unquestioned belief in the invisible forces behind markets and their vague welfare-maximization properties.[28] A more sophisticated support of competition as a basis for the international tax regime developed on political distrust of cooperation at the international level.[29] Such an approach views even the current, soft regime as an influential cartel that services the more powerful countries at the expense of less powerful countries.[30] Yet, the core of this critique is its distrust of the OECD, the club of rich countries that has been the caretaker of the international tax regime.[31] The OECD

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25. H. David Rosenbloom, *The David R. Tillinghast Lecture International Tax Arbitrage and the "International Tax System,"* 53 TAX L. REV. 137 (1999).

26. *See* Tsilly Dagan, *The Tax Treaties Myth*, 32 N.Y.U. J. INT'L LAW & POL. 939 (2000); Tsilly Dagan, *The Costs of International Tax Cooperation*, *in* GLOBALIZATION AND THE WELFARE STATE 49 (E. Benvenisti, G. Nolte, & D. Barak-Erez eds., 2002); Julie Roin, *Taxation Without Coordination*, 31 J. LEGAL STUD. 61 (2002); Julie Roin, *Competition and Evasion: Another Perspective on International Tax Competition*, 89 GEO. L.J. 543 (2001).

27. *See* Brauner, *supra* note 12, at 259–62.

28. *See* Roin, *Taxation Without Coordination*, *supra* note 26.

29. Tsilly Dagan, *BRICS: Theoretical Framework and the Potential of Cooperation*, *in* BRICS AND THE EMERGENCE OF INTERNATIONAL TAX COORDINATION 15 (Yariv Brauner & Pasquale Pistone eds., 2015).

30. *Id.*

31. A good example of the importance of this distrust is the fate of mandatory arbitration that has been promoted by the OECD and the United Nations for over a decade, yet caught little traction beyond a few treaties among exclusively rich countries. This remains the case despite the supposed advantage that mandatory arbitration presents to developing countries that cannot outpower rich countries in the current treaty mutual agreement procedure ("MAP"). It is a common opinion that developing countries expect mandatory arbitration to advantage the rich countries since they expect appropriate arbitrators to originate almost exclusively from the developed world. The renewed promotion of mandatory arbitration in BEPS has not fared much better. The implementation commitment includes approximately twenty countries as of

dominates the regime through its exclusive powers over the OECD Model, which permits it to set the agenda for all developments of the regime. Yet, more fundamentally, the norms contained in the OECD Model are biased in favor of residence taxation that benefits wealthier countries, such as the OECD member states.[32] Any further harmonization, as the claim goes, would have to be based on this bias, further fixating the dominance of the rich countries over all others.

Critics of the competition framework respond that it assures the dominance of the rich countries and their control over the international tax regime.[33] Thus, further competition would not give a voice to the less powerful economies that do not compete on a level playing field with the rich countries and among themselves. The competition framework limits policy choices that may assist developing countries to grow, develop, and even collect sufficient revenue to sustain their policies. Only cooperation at some level would allow these countries to make free and rational policy choices.[34] This approach may be based on general notions of fairness or equity, yet it may also be based on interests that may be mutual to both developed and developing (productive) countries, all of which suffer from poor revenue collection.[35] Such revenue loss may be found in inappropriate tax planning that uses non-productive, so-called "tax haven," jurisdictions to benefit few people at the eventual expense of many others.[36] The BEPS project reflects a realization that more coordination, and

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January 2016, yet, none of them is a developing country. The non-OECD G20 countries that partnered with the OECD in BEPS have all clearly abandoned this route. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], MAKING DISPUTE RESOLUTION MECHANISMS MORE EFFECTIVE, ACTION 14 - 2015 FINAL REPORT 41 (2015) [hereinafter ACTION 14 FINAL REPORT].

32. *But see* Ekkehart Reimer, *5 + 7 = Odd, A Plea for More Consistency Between the PE Definition and Profit Allocation Rules in the OECD Model Tax Convention*, FLA. TAX REV. (forthcoming 2017) (arguing for excessive concessions by the OECD in favor of so-called source countries).

33. *See* Brauner, *supra* note 12, at 307–08.

34. *Id.* at 308.

35. *See id.*

36. As predicted by Reuven S. Avi-Yonah. Reuven S. Avi-Yonah, *Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State,* 113 HARV. L. REV. 1573 (2000).

even some harmonization, may be beneficial to both developed and developing countries.[37]

B. A Disintegration of the International Tax Regime?

While crystallizing, several recent developments have posed challenges to the international tax regime, adding to the difficulties it faces. Recent geopolitical changes have been particularly important in this regard. The general criticism of the OECD and its dominance over the international tax regime sharpened as some of the developing countries that are not members of the OECD began emerging and establishing both economic and political dominance.[38] Most notably, the countries of Brazil, Russia, India, China and the Republic of South Africa ("BRICS"), led by India and China, gained strong positions in the global market and began demanding a corresponding voice in the policymaking process.[39] The OECD anticipated the importance of communicating with non-member states long before these developments and launched an observation program for such countries.[40] Yet, the power to observe proceedings was not sufficient for countries that started viewing themselves as world leaders, especially when, for most purposes, their participation did not result in significant enough changes (subjectively) in the division of tax bases and other norms.[41] The demand for more source taxation conflicted with the opposite trend to eliminate

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37. *See* OECD, *supra* note 3.

38. *See* Yariv Brauner & Pasquale Pistone, *Introduction, in* BRICS AND THE EMERGENCE OF INTERNATIONAL TAX COORDINATION 3–4 (Yariv Brauner & Pasquale Pistone eds., 2015).

39. *Id.*

40. The initiative, originally named the Special Centre for Co-operation with Non-Members, is now under the "Global Relations in Taxation" heading. *See Global Relations in Taxation,* OECD.ORG, http://www.oecd.org/tax/tax-global/ (last visited June 19, 2016).

41. For example, China lost the battle over locational savings, yet continued to pursue it under domestic laws despite its rejection by the BEPS project. *See, e.g.*, Ryan Finley, *Panel Expects Increased Transfer Pricing Compliance Burdens,* 80 TAX NOTES INT'L 488, 489 (2015). India could not achieve finalization or any recommendations regarding action item 1 and the taxation of the digital economy. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], ADDRESSING THE TAX CHALLENGES OF THE DIGITAL ECONOMY, ACTION 1 - 2015 FINAL REPORT (2015) [hereinafter ACTION 1 FINAL REPORT].

source taxation in favor of residence-based taxation that had always been the hallmark of OECD tax policy and a consequence of the competition framework of the international tax regime.[42] Some countries have unilaterally departed from some of the prior universal norms of the international tax regime to assert their tax jurisdiction and views of appropriate division of tax bases.[43]

At the same time, past economic powers have lost some or, in other instances, most of their power (in the case of the United States it lost its superpower). Today, even the United States cannot dominate any international tax policy discussion alone.[44] Globalization and the 2008 financial crisis caused a thirst for revenue among even the most developed countries, which then lacked the capacity to regenerate their collection powers independently.[45]

The first response to this crisis focused on collection and the most traditional and conservative tax treaty measure of information exchange.[46] The thought was that enhanced and inexpensive exchange of information, coupled with the destruction of

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42. *See, e.g.*, Reimer, *supra* note 32.

43. Finley, *supra* note 41, at 488. Another example includes the renewed collection demand of Vodafone by India following the litigation regarding India's exceptional taxation (from OECD norms) of indirect share transfers. Stephanie Soong Johnston, *India Renews $2.1 Billion Vodafone Tax Demand,* 81 TAX NOTES INT'L 650, 651 (2016).

44. Examples for this loss of power could be the inability of the United States to have the BEPS project recommend the inclusion of controlled foreign corporation ("CFC") measures under action item 3. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], DESIGNING EFFECTIVE CONTROLLED FOREIGN COMPANY RULES, ACTION 3 - 2015 FINAL REPORT (2015) [hereinafter ACTION 3 FINAL REPORT]; Ryan Finley, *The Year in BEPS: Phase 1 Completed,* 80 TAX NOTES INT'L 983, 985 (2015). Another such example is the very limited response to the most important item on the U.S. list in BEPS: mandatory arbitration. *See* ACTION 14 FINAL REPORT, *supra* note 31, at 41.

45. Hence, the BEPS project. The one possible exception to this may be the U.S. ability to implement its domestic Foreign Account Tax Compliance Act (FATCA) legislations and essentially force the rest of the world to cooperate with its collection efforts. Yet, this may be a minor exception if one notes that FATCA may be convenient for foreign tax authorities in their own pursuit of aggressive collection and would lay the political blame at the feet of the United States.

46. MODEL TAX CONVENTION ON INCOME AND ON CAPITAL art. 26 (ORG. FOR ECON. CO-OPERATION & DEV. 2010) [hereinafter OECD MODEL CONVENTION 2010].

bank secrecy, would eliminate most abusive tax planning and restore the power of the old international tax regime. Yet, the nature of the global market of information and contemporary tax planning prevented rich economies from implementing this solution alone. The power effectively shifted in part to the Group of Twenty (G20) organization, which includes some OECD members as well as emerging economies that do not belong to the OECD but have an equal voice to that of the traditional powers in the G20.[47] The outcome was the "Global Forum."[48] The BEPS project was the next step wherein the G20 took initiative, even if in cooperation with the OECD, following the pattern of the Global Forum.[49]

The same phenomena resulted in not only political challenges to the international tax regime but also direct challenges to the efficacy of the norms. "New" economic trends, including the ascent of electronic commerce, intangibles, sophisticated financial instruments in global capital markets, and multinational enterprises ("MNEs") facilitated by globalization, have all dumbfounded the prevailing norms that have been established for a simpler, "smaller," brick-and-mortar world. For many of these transactions, the norms became apparently inadequate, as did the structural foundations of the international tax regimes, such as the dichotomy between source and residence. These challenges to the norms of the regime have tested the efficacy of tax treaties and their future as the foundation of the regime. They also further exposed the already existing and perhaps inherent weaknesses of tax treaties.

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47. *See* Mindy Herzfeld, *News Analysis: Why BEPS is Just the Beginning*, 79 TAX NOTES INT'L 983 (2015).

48. *Global Forum on Transparency and Exchange of Information for Tax Purposes*, OECD.ORG, http://www.oecd.org/tax/transparency/ (last visited Mar. 1, 2016) [hereinafter *Global Forum on Transparency*]. Note, however, that in practice, the forum is heavily influenced by the richest countries and relies on the OECD politically and administratively.

49. Some have even identified a pattern in the G20's actions on tax. *See, e.g.*, Itai Grinberg, *The New International Tax Diplomacy,* 104 GEO. L.J. 1137 (2016). This pattern is too tentative and misleading since, as explained here, the leading OECD economies and the OECD itself have been the primary winners from BEPS in this context.

C. The Nature and Purpose of Tax Treaties

In construction, shocks and crises often expose cracks in the foundation. This is clearly true for tax treaties in recent times. This is also a good occasion for an inquiry into the nature and purpose of tax treaties. Such an inquiry has rarely been made since tax treaties are viewed as instrumental devices for the division of tax bases among countries. A reference to the "avoidance of double taxation" is often made as an immediate response to any question about the purpose of tax treaties. This reference has a strong backing in the history of tax treaties developed among neighboring jurisdictions to resolve border-related tax jurisdiction conflicts.[50] Furthermore, the origins of the tax treaty project—found in the work of the 1920s League of Nations—can also be traced to the desire to facilitate cross-border trade and investment.[51] The basic idea was simply to eliminate tax barriers that result from conflicting claims, mainly those based on source on the one hand and residence on the other hand. The actual division of the tax base did not (and still does not) follow any recognizable policy principle. It was constructed from a patchwork of norms that followed efficiency-based observations, perceived fairness, and other legitimacy-based constructs. Thus, a source country could only tax income generated by a foreign person with significant presence within its jurisdiction, yet it received essentially a free pass to tax income related to real property located within its jurisdiction. Appropriate here is an observation by Secretary of the Treasury Andrew Mellon, quoted in the influential Vogel book on tax treaties: "[T]he concessions are more likely to be based on bargaining than on sound principles of taxation."[52]

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50. *See* Sunita Jogarajan, *Stamp, Seligman and the Drafting of the 1923 Experts' Report on Double Taxation*, 5 WORLD TAX J. 368 (2013) (exposing the history of the League of Nations tax treaty work and the centrality of double taxation to this work); *see also* A. J. VAN DEN TEMPEL, RELIEF FROM DOUBLE TAXATION (1967) (extending the analysis to the takeover of the tax treaty project from the League of Nations by the OECD); Richard J. Vann, *Writing Tax Treaty History* 12–13 (Sydney Law Sch. Legal Studies Research Paper Series, Paper No. 10/19, 2011), http://ssrn.com/abstract=1788603.

51. *See* Jogarajan, *supra* note 50; *Report on Double Taxation Submitted to the Financial Committee by Professors Bruins, Einaudi, Seligman, and Sir Josiah Stamp*, League of Nations Doc. E.F.S. 73.F.19 (1923).

52. KLAUS VOGEL, KLAUS VOGEL ON DOUBLE TAXATION CONVENTIONS: A COMMENTARY TO THE OECD, UN, AND US MODEL CONVENTIONS FOR THE

The commitment to eliminate double taxation itself, however, is limited. First, there is controversy over what constitutes double taxation.[53] This may not be important in most cases of tax treaty interpretation since treaty provisions do not include a direct reference to this concept. Rather, they reference an instrumental rule with, perhaps, the effect of double tax elimination. Second, treaties generally eliminate juridical rather than economic double taxation (i.e., they are concerned with the technical rather than the actual incidence of taxation[54]). Finally, treaties explicitly do not eliminate all double taxation. There are various situations that treaties cannot resolve and these situations are simply left unresolved, leaving tax authorities to address them eventually, or not.[55]

An important issue concerns multiparty transactions that extend beyond two jurisdictions that are parties to a tax treaty (often called "triangular situations"). Most of these remain beyond the reach of current treaty law because they are bilateral.[56] While the limited scope of tax treaties may be viewed as one of their strengths, because they address only resolvable cases where possible, in recent years it has become a more significant limitation. Globalization and the rise of MNEs naturally make most global trade multilateral rather than bilateral, and the bilateral nature of tax treaties has become more of a liability than an advantage as a result.

A similar development challenges a second, and perhaps, originally inferior purpose of tax treaties, phrased as the combat of fiscal evasion. This purpose was satisfied primarily by a provision that loosely obligated the parties to exchange relevant tax information among them.[57] Later developments added a weak

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AVOIDANCE OF DOUBLE TAXATION ON INCOME AND CAPITAL, WITH PARTICULAR REFERENCE TO GERMAN TREATY PRACTICE 4 (3d. ed. 1997).

53. *Id.*

54. U.N. Comm. of Experts on Int'l Cooperation in Tax Matters, *Note on the Revision of the Manual for Negotiation of Bilateral Tax Treaties* U.N. Doc. E/C.18/2011/CRP.11 (Oct. 19, 2011), http://www.un.org/esa/ffd/tax/seventhsession/CRP11_Introduction_2011.pdf.

55. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], COMMENTARIES ON THE ARTICLES OF THE MODEL TAX CONVENTION arts. 23A, 23B, para. 32 (2010) [hereinafter OECD COMMENTARIES].

56. *See* EMILY FETT, TRIANGULAR CASES: THE APPLICATION OF BILATERAL INCOME TAX TREATIES IN MULTILATERAL SITUATIONS (2014).

57. OECD MODEL CONVENTION 2010, *supra* note 46, art. 26.

commitment to assist in the collection of taxes and a loose matching of policies among the parties.[58] With the turn of the millennium, the term double non-taxation was coined to strengthen this corollary function of tax treaties.[59] Accepting that the international tax regime wishes to follow a single tax principle, parties permitted a regime based on a general sentiment: to avoid overburdening cross-border investors and create incentives based on tax law to invest abroad.[60] This principle appeals not only to the common sense and equitable view of the regime but also to supporters of the competition-based framework since such a principle may also be read as an efficiency-enhancing, neutrality-promoting principle. The problem is the language and the perceived metaphor since double taxation and double non-taxation naturally sound like parallel, mirror problems, especially when based on a single principle. Yet, pragmatically, they represent very different challenges and difficulties in implementation.[61] Governments were attracted by this articulation, identifying new opportunities to use tax treaties to support their collection and enforcement efforts. Consequently, the OECD identified this as an opportunity to enhance its influence

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58. One such example is the claw-back exemption with progression, where one country imposes its tax rates based not only on the income associated with its jurisdiction but rather based on the worldwide income of the taxpayer, for example, the calculation of which requires information available typically only through cooperation with its treaty partner or partners.

59. The main milestone in the launch of double non-taxation as a corollary to double taxation is probably its choice as a main issue in the 2004 International Fiscal Association congress in Vienna. *See* Int'l Fiscal Assoc., 89a CAHIERS DE DROIT FISCAL INTERNATIONAL (2004).

60. For a review of the evolution of the single tax principle, see Reuven S. Avi-Yonah, *Who Invented the Single Tax Principle? An Essay on the History of US Treaty Policy* (Univ. of Mich. Law Sch., Pub. Law & Legal Theory Research Paper Series, Paper No. 318, 2014), http://ssrn.com/abstract=2226309. For the original exposition of the single tax principle as a fundamental pillar of the international tax regime, see Reuven S. Avi-Yonah, *International Taxation of Electronic Commerce*, 52 TAX L. REV. 507 (1997).

61. For more information, see my critique of BEPS action item 2 (Hybrid Mismatches). *See* Yariv Brauner, *The Bad, the Worse, and the Ugly, in* BASE EROSION AND PROFIT SHIFTING (BEPS): IMPACT FOR OECD AND EU TAX POLICY (Robert Danon ed., 2016).

on the international tax regime. In a way, the whole BEPS project is about double non-taxation and its introduction into the international tax regime.[62]

An additional view of tax treaties emphasizes their role as comity mechanisms, similar to membership cards in a club of proper jurisdictions.[63] The mere existence of a tax treaty seems to send a signal of normalcy and relative safety for investment. Tax treaties also institutionalize lines of communication between tax authorities on both bilateral and multilateral levels, and in some cases legitimize such discourse in fiscal rather than diplomatic channels. Finally, tax treaties present opportunities to amend tax laws in a manner that avoids domestic politics. Tax treaties provide flexibility for the executive branch and add an additional layer of checks and balances, albeit with a democratic deficit.

This view accepts the imperfections of tax treaties on both fronts (double taxation and double non-taxation). It further accepts that such goals may be met without tax treaties in loose coordination arrangements or even on a unilateral basis.[64] Such a view better explains the role of tax treaties in the construction of the international tax regime than that of their traditional and allegedly instrumental purposes. Additionally, it accounts for the continuous desire of countries to enter into tax treaties without careful accounting for their straightforward costs and benefits.[65]

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62. A more detailed discussion of this concept will be covered in the next section.

63. Brauner, *supra* note 12, at 292.

64. *See* Dagan, *Tax Treaties Myth*, *supra* note 26.

65. Note that the economic literature on tax treaties is divided regarding their desirability as investment enhancers. *See* Bruce A. Blonigen & Ronald B. Davies, *The Effects of Bilateral Tax Treaties on U.S. FDI Activity* (Univ. of Or., Econ. Working Paper No. 2001-14, 2001), http://ssrn.com/abstract=445980; Ronald B. Davies, *Tax Treaties, Renegotiations, and Foreign Direct Investment* (Univ. of Or., Econ. Working Paper No. 2003-14, 2001), http://ssrn.com/abstract=436502; Peter Egger, *The Impact of Endogenous Tax Treaties on Foreign Direct Investment: Theory and Evidence*, 39 CAN. J. ECON. 901 (2006); Eric Neumayer, *Do Double Taxation Treaties Increase Foreign Direct Investment to Developing Countries?*, 43 J. DEV. STUD. 1495 (2007).

II. BEPS

With much fanfare, the OECD announced the launch of the BEPS project in 2013.[66] Its excitement, as well as the optimism of most stakeholders, has since waned,[67] yet the intensity of the work on the project and its impact have not. International tax policy is still as hot a topic in 2016 as it was in 2012 or 2013. This may be surprising for some since, at its core, BEPS is a political project. G20 politicians initiated the project in response to a public outrage over some large corporations' use of tax-planning schemes, which subsequently was fueled by the media's interest and exposure of these schemes.[68] Interestingly, the OECD was charged with fixing the problem, and fixing it quickly.[69] This is the same OECD organization that had been the caretaker of the international tax regime during the last half century and, in some ways, may be viewed as responsible for the problem it was charged with fixing.

Yet, for the OECD, this presented an opportunity in the form of political support for reform that had always been difficult to garner. The opportunity was, however, also fraught with challenges. First, the political charge was not accompanied by clear guidance about the goals and purposes of the project. On the one hand, it was clear that schemes of the sorts exposed by the media as having the effect of BEPS should have been addressed.[70] On the other hand, a more comprehensive reform would have been required to prevent different schemes from replacing them.[71]

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66. *See* OECD, *supra* note 3. The G20 Leaders Declaration of September 2013 provided the expanded political mandate enjoyed by the OECD. Group of Twenty [G-20], *St. Petersburg Summit Leaders' Declaration* (Sept. 5–6, 2013), https://www.g20.org.tr/wp-content/uploads/2014/12/Saint_Petersburg_Declaration_ENG.pdf. The mandate followed the Los Cabos declaration launching the project. *See* Group of Twenty [G-20], *Los Cabos Summit Leaders' Declaration* ¶ 48 (June 18–19 2012), https://g20.org.tr/wp-content/uploads/2014/12/G20_Leaders_Declaration_Final_Los_Cabos_0.pdf.

67. Take, for example, the United States. *See* Lee A. Sheppard, *News Analysis: BEPS Progress Report*, 142 TAX NOTES 1154, 1154 (2014) ("Remember, BEPS is a European project. It is EU governments beating up on U.S. multinationals . . . ."); Mindy Herzfeld, *News Analysis: The U.S. Treasury and the BEPS Mess*, 78 TAX NOTES INT'L 1067 (2015).

68. *See supra* text accompanying note 6.

69. *Los Cabos Summit Leaders' Declaration*, *supra* note 66, ¶ 48.

70. Action items 2, 6, and 8–10 may be viewed as focusing on these transactions. *See* OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 5, at 15–20.

71. Thus, action items 3, 6, 8–10, 13, and 15, in particular. *Id.* at 16–24.

Such reform would have been necessary regardless of BEPS due to other imminent needs, such as the ascent of the digital economy, the ineffectiveness of the transfer-pricing rules, and the rise of emerging economies.

Second, the OECD tax work, especially the maintenance of the OECD Model, positioned the organization as the absolute leader or caretaker of the international tax regime. Yet, such maintenance requires political will that is often deficient to constantly reform and adapt the model to the changing circumstances, such as globalization and crises. The political will granted in the BEPS context presented an opportunity to promote reform that would have been otherwise difficult. At the same time, the leading OECD countries had all been struggling with economic crises and difficulties to collect much needed revenue. Consequently, BEPS provided the OECD with both an opportunity to strengthen its position but also a challenge to ensure revenue collection by the world's richest economies.

Third, the timing of BEPS, perhaps not accidentally, coincided with dramatic geopolitical shifts of power directly affecting the OECD in general and its position as a leader in the design of international tax policy in particular. The rise of the large emerging economies, most notably BRICS, caused these countries to demand a voice in the policymaking process (including tax policy). This, of course, is not new: the OECD had granted some of these countries, most notably China and India, the right to participate as observers in its tax policy-making meetings.[72] Yet, in the BEPS context, BRICS countries have a similar status as leading OECD members because the BRICS are equal members in the G20, which includes some but not all OECD members. This is a new and likely source of contention, especially on matters that consistently divide developed and developing countries. What is clear is that source jurisdictions should benefit under BEPS from an increased share of tax bases, yet the extent of the benefit and how to fit the shift into a coherent reform of the international tax regime remains far from clear.

Against this complex background, the OECD devised a diverse action plan with a (now well-known) list of fifteen specific action

72. For a complete list of OECD membership and affiliations, see *Members and Partners*, OECD.ORG, http://www.oecd.org/about/membersandpartners/ (last visited June 9, 2016) (listing nations with OECD membership).

items.[73] The plan is not cohesive, yet, together with the original OECD BEPS report, one could identify three basic insights it provides.[74] The first, and most important insight for the purposes of this article, is that international coordination of tax policies is a condition for the success of any substantial reform; and, therefore, unilateral action, regardless of its substance, cannot succeed by definition. This insight stands in stark contrast to the most fundamental basis of our current competition-based international tax regime. It is clear that such desired coordination has to include non-OECD countries, which would at least challenge the dominance of this organization over the international tax regime.

A second insight of the BEPS project relates to the importance of comprehensive and holistic reform rather than *ad hoc*, partial reforms that have been typical of the regime. Note that the OECD could not generally be blamed for past practices in this context since this was clearly a consequence of political will beyond its control. Nonetheless, despite the rhetoric, OECD personnel have bluntly ignored this insight throughout the project, in both public statements and in their reports, preferring "pragmatic" and specific "solutions" and avoiding principles.[75]

A third insight of the BEPS project is that there are certain challenges that have been underestimated and dealt with in traditional means, usually by analogy to old-economy issues.[76] It is clear that many of these challenges require a different approach that includes innovation. The most dramatic signal about this insight is the willingness to slaughter the holiest of cows and go "beyond" arm's length in transfer-pricing practices.[77] In reality, BEPS has failed to innovate beyond the new transfer-pricing reporting rules and, perhaps, in the initiative to establish a multilateral instrument.

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73. *Id.*

74. *See* Yariv Brauner, *BEPS: An Interim Evaluation*, 6 WORLD TAX J. 1, 12 (2014).

75. *See, e.g.*, Pascal Saint-Amans, *The OECD Work on Base Erosion and Profit Shifting*, YOUTUBE (Apr. 16, 2013), https://www.youtube.com/watch?v=b9VhFGU5mvI (discussing the Centre for Tax Policy and Administration and the OECD's work on BEPS).

76. *See, e.g.*, ORG. FOR ECON. CO-OPERATION & DEV. [OECD], ARE THE CURRENT TREATY RULES FOR TAXING BUSINESS PROFITS APPROPRIATE FOR E-COMMERCE? 18 (2004).

77. *See* OECD, *supra* note 3, at 45.

Interim analyses of the BEPS project determined that it has failed to adhere to its basic insights.[78] In particular, treaty-related issues suffered a lack of progress. This article next engages in a concise, final report on the outcomes of BEPS, as the project winds down, in order to assess the project's impact on the future of tax treaties.

A. A Concise (and Almost) Final Report on the BEPS Action Plan

This section briefly reviews the goals of each of the plan's action items compared with their achievements. One should realize that most action items require additional work before they can be implemented, if at all; others resulted in no operative recommendations.

1. Action Item 1: Address the Tax Challenges of the Digital Economy

Action item 1 required a report discussing the challenges posed by the digital economy to the current international tax regime, which was never designed for it.[79] The regime failed to adapt to technological progress and to the ascent of intangibles, as it merely tweaked the rules[80] in an apparently unsatisfactorily manner to fit these developments.[81] The BEPS context was obvious since MNEs, whose use of tax-planning schemes triggered the launch of the BEPS project, all have heavily relied on

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78. *See* Brauner, *supra* note 74, at 38; Sheppard, *supra* note 67.

79. *See, e.g.*, Chang Hee Lee, *Impact of E-Commerce on Allocation of Tax Revenue Between Developed and Developing Countries*, 4 J. KOREAN L., no. 1, 2004, at 19, 21 ("[D]igital technology completely destroys the economic and legal basis for the existing rules of international taxation, implying the necessity of a complete overhaul . . . .").

80. *See, e.g.*, OECD, *supra* note 76, at 54; ORG. FOR ECON. CO-OPERATION & DEV. [OECD], E-COMMERCE: TRANSFER PRICING AND BUSINESS PROFITS TAXATION 113 (2005). The most significant outcomes of this work were the changes to Article 5 in the OECD Commentary on the Model Tax Convention, resulting in the addition of paragraphs 42.1–42.10. OECD COMMENTARIES, *supra* note 55, art. 5, para. 42.1–42.10.

81. This is evidenced by the OECD identifying the "[a]pplication of treaty concepts to profits derived from the delivery of digital goods and services" as a key pressure area that must be addressed by the BEPS project, later reflected in action item 1. *See* OECD, *supra* note 3, at 47.

intangibles in exploiting the tax advantages of an imperfectly regulated digital economy.[82]

The goal of this item was modest: the generation of a report. In fact, the OECD quickly understood that more than that was required. Consequently, the OECD focused on a few reasonable solutions for the most important issues at stake. The final action item 1 report acknowledges the need for post-BEPS monitoring and seems to state that the digital economy taskforce will continue to exist for implementation and monitoring purposes.[83] It is unclear, however, whether meaningful action will be taken on any of the issues discussed. Action was taken regarding consumption taxes, and a plan for implementation is in play,[84] yet no operative steps are planned in the income tax area.

The final report mentions three possible income tax measures available for countries to adopt, yet it does not recommend (nor does it strictly oppose) them: (i) nexus-based taxation,[85] (ii) a withholding tax on digital transactions,[86] and (iii) an equalization levy. The report asserts that other BEPS measures should ameliorate the pressure created by the digital economy on tax enforcement, rendering special measures unnecessary. The OECD failed, however, to explain how that would occur or which operative norms would so govern. No accountability or monitoring measures were provided or discussed.

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82. *See supra* text accompanying note 6.

83. Yet, no final recommendations have been furnished and no practical action has been taken to actually establish a follow-up forum in the same manner already done regarding other items, such as the consumption tax aspects of action items 1, 14, and 15. *See* ACTION 1 FINAL REPORT, *supra* note 41, at 13; ACTION 14 FINAL REPORT, *supra* note 31, at 37–41; ORG. FOR ECON. CO-OPERATION & DEV. [OECD], DEVELOPING A MULTILATERAL INSTRUMENT TO MODIFY BILATERAL TAX TREATIES, ACTION 15 - 2015 FINAL REPORT (2015) [hereinafter ACTION 15 FINAL REPORT].

84. Consumption tax implications of BEPS are beyond the scope of this article.

85. Peter Hongler & Pasquale Pistone, *Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy* 2 (Int'l Bureau of Fiscal Documentation, Working Paper No. 20, 2015), ssrn.com/abstract=2586196.

86. *See* Yariv Brauner & Andres Baez Moreno, *Withholding Taxes in the Service of BEPS Action 1: Address the Tax Challenges of the Digital Economy* (WU Int'l Taxation Research, Paper No. 2015-14, 2015), http://ssrn.com/abstract=2591830; *see also* Richard Doernberg, *Electronic Commerce and International Tax Sharing*, 16 TAX NOTES INT'L 1013 (1998).

This is a very conservative move by the OECD. It clearly ignores the necessity of innovation that is the third insight of BEPS. It says: "Yes, we acknowledge our failure to date, but, trust us, now we are really going to get it right." Realistically, the OECD probably anticipated the lack of progress on the matter due to the vow of BEPS for consensus. In the case of the digital economy, consensus meant stagnation.

Yet, inaction might be undesirable for the stability of the international tax regime, even when disagreements run deep. Several countries do not trust the OECD on this matter. These countries have already enacted a variety of unilateral measures.[87] This may leave other countries with little choice but to follow. The adoption of these measures, again, will be uncoordinated and contrary to the first insight of BEPS. The lack of commitment to solving the issues through the OECD would then make matters worse, not better. It is of course possible that some countries would coordinate a new set of standard rules for the taxation of the digital economy outside of the OECD. This would be consistent with BEPS, yet success in such action would be a tall order without the infrastructure of the BEPS project in place, and realistically, one cannot see any indication that that is likely to happen. Defensive, unilateral action based on rough justice and vague guidance to taxpayers is much more likely to occur in the short-term.

The impact of this action item on tax treaties will be miniscule. Yet, countries adopting a nexus-based solution may change their Article 5 definitions, effectively following a "digital PE" route.[88]

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87. *See, e.g.*, *Italy Considers Introduction of Tax on Digital Activities*, EY (Apr. 27, 2015), http://www.ey.com/GL/en/Services/Tax/International-Tax/Alert—Italy-considers-introduction-of-tax-on-digital-activities; *The Latest on BEPS*, EY (Apr. 27, 2015), http://www.ey.com/Publication/vwLUAssets/Alert:_The_Latest_on_BEPS_-_27_April_2015/$FILE/2015G_CM5405_The%20Latest%20on%20BEPS%20-%2027%20April%202015.pdf.

88. PE has become the universal norm for taxation of business income earned by foreign taxpayers in host countries. The norm is that only permanent business activities in terms of both place and time may be taxed by such host (or "source") countries. Such permanence must be manifested by both people on the ground and a physical element such as bricks, walls, etc. This rule is viewed as anachronistic in the digital age since very significant business may be done (in the colloquial sense) without having the abovementioned phys-

Countries refusing such solutions will have to deal with the eventual double taxation claims at the mutual agreement procedure level and, perhaps, claims of treaty overrides as well. The challenge of the digital economy will not simply go away. The failure of BEPS to achieve progress in this context made things worse for all stakeholders.

2. Action Item 2: Neutralize the Effects of Hybrid Mismatch Arrangements

Action item 2 addresses hybrid mismatch arrangements, the very essence of BEPS. Hybrid mismatch arrangements are tax-planning schemes that exploit differences between the laws of the jurisdictions involved to minimize taxation in an inappropriate manner. What is inappropriate in this context? Taxpayers cannot be blamed for organizing their affairs in manners that take advantage of mere differences in tax laws, as this is the essence of all tax planning, and even further, some of these differences are clearly intentional. Indeed, some of these differences are part of tax competition that is at the core of the international tax regime. Moreover, even the little bit of coordination provided by tax treaties is manifestly incomplete. There are many instances of double taxation not resolved by tax treaty norms because the competing jurisdictions cannot agree on how to resolve them. Certain conflicts of qualifications and conflicts regarding corporate residence are salient examples.[89]

Nonetheless, hybrid mismatches are difficult to stomach for the international tax regime since they present income that one feels obviously should be taxed, but is not. It is not taxed either because it is "stateless,"[90] it is generated by a hybrid entity, or it is characterized differently in different jurisdictions. Only a dou-

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ical elements within the host jurisdiction. The digital PE expands the PE concept to include also significant digital footprint in a host country granting it taxing rights despite the absence of significant physical presence by foreign taxpayers within its jurisdiction. The BEPS project rejected the "digital PE" route. *See* ACTION 1 FINAL REPORT, *supra* note 41; *see also* Lee A. Sheppard, *News Analysis: OECD BEPS Project Unlikely to Endorse Digital PE*, TAX ANALYSTS (Jan. 27, 2014), http://www.taxanalysts.org/content/oecd-beps-project-unlikely-endorse-digital-pe.

89. *See supra* note 46.

90. *See* Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699 (2011).

ble non-taxation perspective could provide a practicable framework for identifying what is inappropriate in tax planning that relies on mismatches.[91]

The final report clearly identifies the problem created by hybrid mismatches as one of double non-taxation, yet it chooses to recommend a two-pronged solution that does not include a clear articulation of double non-taxation as a fundamental principle of the international tax regime or tax treaties. The principle of double non-taxation, regardless of its desirability, could at least guide the future development of standards of application and operative rules to combat the undesirable consequences of hybrid mismatch arrangements.

Instead, the report recommends amendments to domestic and model treaty laws.[92] This approach demonstrates a clear preference for minimizing the scope for the BEPS project and rejecting the opportunity it presents for a comprehensive international tax reform. One may argue that the OECD has taken a "pragmatic" approach, yet this would merely be camouflaging the policy choice taken by the OECD on this matter. It would also be a clear retreat from the general obligation of the OECD to the fundamental insights of BEPS. The emphasis on domestic anti-abuse rules all but eliminates the commitment to a collaborative approach, relying primarily on *ad hoc*, unilateral measures with no innovation, as the recommendations replicate work already launched by the OECD in the pre-BEPS era.[93]

Part I of the report includes a set of specific recommendations based on domestic law changes to combat payments made under hybrid financial instruments or by a hybrid entity or hybrid mismatches imported into a third jurisdiction. The idea here was to establish a set of "best practices" based on the theory that if all countries follow such practices, hybrid mismatches would not result in undesirable outcomes. Yet, even the report itself seems unconvinced that the desired result would occur, and hence it proposes alternative, "defensive" domestic anti-abuse rules that would be effective in cases where relevant countries do not follow the first-order recommendations. The OECD did not explain why

91. *See* Brauner, *supra* note 61.

92. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], NEUTRALISING THE EFFECTS OF HYBRID MISMATCH ARRANGEMENTS, ACTION 2 - 2015 FINAL REPORT (2015).

93. *See* OECD, *supra* note 3, *Annex D*: Current and Past OECD Work Related to Base Erosion and Profit Shifting, at 83–87.

it expects that countries would ignore self-interest, best self-assessment of the desirable rules, and the possibility of defection by other countries in order to follow its best practices. The provision of the defensive rules is proof that the OECD does not believe that progress toward resolving lack of coordination that leads to BEPS and hybrid tax planning can truly be made. One is left puzzling how that is different from the current state of affairs.

Yet, the content of these proposed best practices is even worse than the refusal to admit defeat. It lacks any logic or reason and does not even rely on a double non-taxation framework. The OECD simply chose one set of countries (generally the residences of the payors) to make concessions over others (generally the residences of the payees) in a variety of specific tax-planning outcomes. The OECD decided, without any explanation or analysis, the consequences of these choices. It is all neatly set in elaborate tables, but nothing is provided in terms of the rationale or even an assessment of the winners or losers from the recommendations. The solutions provided by the OECD are merely technical. Why would countries follow these recommendations unless they expect to "win" accidentally, and even then, their winning is conditional upon the "loser" country's decision to follow the rules as well for reasons unfathomable? Of course, even arbitrary arrangements could work in a well-coordinated regime when participants believe that, overall, they would benefit from such a regime, yet this is not the case here. The action item did not establish or even fully discuss such a coordination mechanism. Countries could easily defect with essentially no consequences.

The stubborn reluctance to deal with principles that haunt this action item may eventually become the focus of attention, mismatches being the most direct articulation of BEPS-style planning. The OECD is attracted to the appeal of the so-called single tax principle and, more specifically, the view of double taxation and double non-taxation as parallel or mirror problems. Yet, as already mentioned, the implementation of this view in practice is problematic (despite the OECD approach to action item 2 being pragmatic) since requiring a jurisdiction to concede taxation is very different from requiring it to tax when it does not wish to. In the former case, revenue may be lost, yet a promise of more investment and a better competitive position ensues. In the latter situation, however, the jurisdiction gets some revenue, if any,

in exchange for a worse competitive position because the country had already made that assessment when it chose not to tax in the first place. The actual recommendation primarily is to deny the deduction and not to tax the non-included income, yet the impact is similar. Domestically, this choice could be worse than reluctant inclusions since identical transactions would get a deduction in the purely domestic setting but not across borders, which is manifestly inefficient.

Part II of the report complements these rules with required treaty changes to ensure the compatibility of treaties with the recommendations of Part I. This part focuses mainly on the difficulty of establishing corporate residence, which is an unresolved issue to date.[94] The solution is to drop the current proposed general and tie-breaking rule of effective management and replace it with a case-by-case analysis. This is reasonable because the current rule had no chance of implementation in the first place, yet, to replace it with a no-test (case-by-case analysis) would not project progress.[95] The lack of a solution for this issue signals a weakness of the BEPS project. Of course, it does not innovate, for instance, by eliminating the need to determine corporate residence. Such conservatism is, again, in contrast to the BEPS insights.

One cannot ignore the centrality of the United States' check-the-box regime[96] in this context as well as its effective refusal to discuss its reform. What is at stake here is a real issue that not only features well in tax planning generally but also figures prominently in the actual transactions that triggered the BEPS project. Nonetheless, the BEPS project chose to ignore this elephant in the room.

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94. Omri Y. Marian, *Jurisdiction to Tax Corporations*, 54 B.C. L. REV. 1613 (2013).

95. A no-test, ultimately, is more desirable in terms of policy than the current norm, yet, in the context of BEPS, one cannot avoid the conclusion that it did not push the BEPS agenda forward, regardless of what one thinks the purpose of the project should have been.

96. Treas. Reg. § 301.7701-3 (as amended in 2016). CTB apparently came under significant scrutiny in the BEPS context, yet the United States appears adamant on keeping it. *See* David D. Stewart, *BEPS Seen as Area of Both Consensus and Conflict*, TAX NOTES TODAY (Sept. 19, 2013), http://www.taxnotes.com/tax-notes-today/corporate-taxation/beps-seen-area-both-consensus-and-conflict/2013/09/19/41796.

The report further recommends implementation of the 1999 OECD Partnership Report[97] in the form of a model convention provision and commentary. The problem here is that the OECD's partnership report has made little progress in the fifteen years since it was published and has faced much criticism. The OECD promises that it will really work once all of the countries adopt it. Yet, there is no innovation or any other new arguments to convince opponents and perceived losers to join in. Lastly, the action item 2 final report tackles potential conflicts between the proposed (mostly domestic) rules and current treaties and gladly asserts that, if the OECD recommendations were accepted as is, no conflicts should arise. This part reads again like an advertising conclusion with no principles and no analysis.

In conclusion, this action item should result in little to no impact on tax treaties. The removal of the unworkable tie-breaking rule for corporate residence is appropriate, but is merely cosmetic because it had no realistic chance of impact anyway. Some countries, however, may choose to include specific rules regarding partnerships and hybrid entities in tax treaties, perhaps following the OECD recommendation in its partnership report. It is unlikely that such inclusion would be universal, however, because so many of the mismatch issues would remain intact. Yet, in treaties between some like-minded treaty partners, this could be positive since it would provide more clarity on this important issue. There are no actual signs, however, that such action is effectively planned anywhere.

3. Action Item 3: Strengthen Controlled Foreign Corporation Rules

Deferral is an important feature of tax planning in most productive countries. Therefore, reform of anti-deferral regimes, such as the controlled foreign corporation ("CFC") rules, supposedly makes sense within the BEPS project.[98] It is not only important but also relevant because the most conspicuous failures

97. *See* Org. for Econ. Co-operation & Dev. [OECD], *The Application of the OECD Model Tax Convention to Partnerships*, ISSUES IN INT'L TAXATION, no. 6, Aug. 26, 1999; MICHAEL LANG, THE APPLICATION OF THE OECD MODEL TAX CONVENTION TO PARTNERSHIPS: A CRITICAL ANALYSIS OF THE REPORT PREPARED BY THE OECD COMMITTEE ON FISCAL AFFAIRS (1999).

98. *See* ACTION 3 FINAL REPORT, *supra* note 44.

of the United States' Subpart F regime[99] were exploited in the classic BEPS-initiating schemes.[100] Yet, these were rather particular to U.S. law. CFC rules are mostly unilateral measures used by residence countries to protect their tax base as they view it within the framework of the current competition-based international tax regime. Source countries tolerate them, so long as they are limited in scope, but only as part of the general rules of the competition game. Now, the residence countries, via BEPS, wish to generalize the use of CFC rules, recruiting other countries (at the expense of these other countries) to protect their tax bases for no consideration. It is difficult to understand why the other countries would make any effort to accommodate these wishes.

Moreover, the wisdom of the choice to focus on CFC regimes is questionable. The OECD has not done much work in this area beyond legitimizing CFC legislation as not being contradictory to tax treaty obligations.[101] CFC regimes are a common title for a variety of legal constructs that tax income from foreign investment of resident taxpayers.[102] Nonetheless, the value of deferral is not merely the time value of money supposedly gained but in ancillary rules and potential rate changes that make deferral attractive for tax planning.[103] These different methods have different goals and effects,[104] so it would be tricky to develop best practices here. It would be especially difficult to sell such a regime to countries not worried about deferral but worried about the cost of enforcing the CFC rules without BEPS-related or other reasons.

The report effectively reads like reluctant recommendations for those wishing to legislate CFC rules. It is clear that the

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99. This is Subpart F of the Internal Revenue Code, §§ 951–960, which includes the United States' CFC rules. I.R.C. §§ 951–960.

100. These schemes were widely exposed elsewhere. *See supra* text accompanying note 6.

101. OECD COMMENTARIES, *supra* note 55, art. 1, para. 23.

102. For example, the OECD's own comparative study. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], CONTROLLED FOREIGN COMPANY LEGISLATION (1996). For a recent study of these regimes, see Int'l Fiscal Assoc., 98a CAHIERS DE DROIT FISCAL INTERNATIONAL (2013).

103. For further explanation, see DANIEL N. SHAVIRO, FIXING U.S. INTERNATIONAL TAXATION (2014).

104. *See supra* text accompanying note 6.

OECD does not expect all countries to follow these recommendations.[105] There are no tax treaty implications for these recommendations.

4. Action Item 4: Limit Base Erosion via Interest Deductions and Other Financial Payments

Action item 4 is again an interesting action item since its focus is quite clear and acceptable as appropriate for BEPS. In fact, in the first stages of the project the consensus opinion was that this would be the first action item to gain consensus since most of the various anti-abuse rules used by countries did not rely on particular policy differences or specific interests but rather on an arbitrary choice out of a not very diverse menu. Yet, progress has stalled. It is likely that institutional interests are at play here since throughout the project the OECD failed to find a best rule for harmonization of interest deductibility rules. Instead, the OECD was busy protecting the arm's length principle and its action item 2 effort that significantly overlapped with action item 4, but was more general and thus more complex to resolve with consensus.

Eventually, however, the OECD came up with the recommendation that was predicted to win the day from the beginning.[106] It is a best practice recommendation to adopt a domestic rule limiting interest (and equivalent) deductions based on a fixed ratio of interest to a percentage of earnings before interest, taxes, depreciation, and amortization ("EBITDA").[107] The OECD recommends that the fixed ratio be sufficiently low, between 10 percent and 30 percent. The OECD, however, also permits a variety of alternative rules. The report further recommends the

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105. Especially not EU member states, which are bound by European Court of Justice (ECJ) jurisprudence that significantly limits the potential scope of CFC regimes. *See* OECD, *supra* note 3, at 38.

106. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], LIMITING BASE EROSION INVOLVING INTEREST DEDUCTIONS AND OTHER FINANCIAL PAYMENTS, ACTION 4 - 2015 FINAL REPORT (2015) [hereinafter ACTION 4 FINAL REPORT].

107. EBITDA is a financial accounting measure typically used as an approximation of a company's operating cash flow based on data from a corporation's income statement. It is relevant in the context of action item 4 since it is essentially the money that the corporation has available for interest payments. Note that EBITDA is relevant for large corporations with significant assets and potential accounting distortions; these are the same corporations that the BEPS project is targeting.

adoption of domestic anti-abuse rules that prevent circumvention of the primary rule, whatever it may be.

It is not difficult to observe that consensus has not been reached here and the OECD cannot rally the troops, even for a best practice single recommendation. Much work remains, as acknowledged by the report itself, so at best a first step toward very loose coordination has been taken, mainly in the form of a better understanding of the options. No impact on tax treaties, however, is expected.

5. Action Item 5: Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance

One of the most newsworthy action items, action item 5, focuses on so-called patent boxes or intellectual property regimes. Yet the scope of this action item is wider and seeks a better articulation and focus to combat harmful tax competition.[108] This is a proper BEPS goal, as it acknowledges that the current competition framework has failed, and a coordinated approach against inappropriate actors is required. Similar to the dilemma presented by action item 2, the difficulty is to identify what is appropriate and what is not. Prior work, including that of the OECD attempting to target types of actors, tax havens, and specific beneficial tax regimes within non-havens, has failed.[109] Therefore, action item 5 attempts a different and perhaps substantive approach.

The final report asserts that countries support an approach based on nexus and substantial activity in a country to justify

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108. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], COUNTERING HARMFUL TAX PRACTICES MORE EFFECTIVELY, TAKING INTO ACCOUNT TRANSPARENCY AND SUBSTANCE, ACTION 5 - 2015 FINAL REPORT (2015) [hereinafter ACTION 5 FINAL REPORT].

109. *See, e.g.*, ORG. FOR ECON. CO-OPERATION & DEV. [OECD], HARMFUL TAX COMPETITION: AN EMERGING GLOBAL ISSUE 13 (1998), http://www.oecd.org/tax/transparency/44430243.pdf. The OECD has even discontinued the maintenance of its Harmful Tax Competition website. For a more optimistic view of the campaign, yet one that includes a fair, and not-so-favorable evaluation of it, see Reuven S. Avi-Yonah, *The OECD Harmful Tax Competition Report: A Tenth Anniversary Retrospective* 1 (Univ. of Mich. Law Sch., Pub. Law & Legal Theory Research Paper Series, Working Paper No. 115, 2008), http://ssrn.com/abstract=1194942.

tax jurisdiction.[110] Costs incurred serve as a proxy for substantial activity in a jurisdiction. This is explained in the patent box context: if a taxpayer incurs significant research and development (R&D) costs in a jurisdiction, she should be able to enjoy a preferential regime that attempts to incentivize R&D in such jurisdiction. So, such a preferential regime would not be considered harmful. This concept should be accompanied with transparency, including the exchange of ruling information.

The proposed concept has not been recommended as a rule but rather as a framework for monitoring and increasing transparency, including a peer-review mechanism. This is a format very similar to that of the Global Forum's and should make the G20 comfortable as well.[111] The problem is that it is not dramatically different from past failed attempts to identify and eliminate harmful tax competition that had followed similar patterns.[112] Substantively, it is based on familiar concepts of substance, nexus, and expenditure and it does not add much clarification to them. A key question here is whether the institutional progress would now make this effort successful where past efforts along similar paths have failed. It is difficult to assess this matter. Further, recent considerations among some leading economies to adopt rather than eliminate the same patent boxes that this action item attempts to target are discouraging signs.[113]

There is no impact on tax treaties beyond the use of transparency mechanisms such as exchange of information provisions. If translated into an effective exchange of tax rulings, however, this modest part of the action plan may eventually develop into

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110. *See* ACTION 5 FINAL REPORT, *supra* note 108.

111. For information on the Global Forum, see *Global Forum on Transparency*, *supra* note 48. For information on the G20 tax work, see Herzfeld, *supra* note 47; Grinberg, *supra* note 49; Itai Grinberg & Joost Pauwelyn, *The Emergence of a New International Tax Regime: The OECD's Package on Base Erosion and Profit Shifting (BEPS)*, ASIL INSIGHTS (Oct. 28, 2015), https://www.asil.org/insights/volume/19/issue/24/emergence-new-international-tax-regime-oecd%E2%80%99s-package-base-erosion-and.

112. Avi-Yonah, *supra* note 109.

113. For example, the proposed bill for the United States to adopt an "innovation box." H. COMM. ON WAYS & MEANS, 112TH CONG., INNOVATION PROMOTION ACT OF 2015 DISCUSSION DRAFT (Comm. Print 2015), http://waysandmeans.house.gov/wp-content/uploads/2015/07/Innovation-Box-2015-Bill-Text.pdf; *U.K. Issues Patent Box Rules Legislation,* WORLDWIDE TAX DAILY (Dec. 9, 2015), http://www.taxnotes.com/imp/18118686.

the sole coordination regime developed in the substantive part of the BEPS action plan to the extent that one views exchange of rulings as substantive. No effective impact in the content of tax treaties is expected.

6. Action Item 6: Preventing the Granting of Treaty Benefits in Inappropriate Circumstances

This peculiar action item makes the statement that BEPS, or abusive tax planning, may be affected through tax treaties.[114] This is a controversial statement since treaties operate at the substantive level merely to restrict domestic law provisions. They do not impose or exempt from taxation and, most importantly, they are essentially elective (even if divergently under different constitutional constructs). Yet, in fact, action item 6 focuses on treaty shopping and fails to establish a meaningful position on what may constitute treaty abuse beyond treaty shopping. Now, treaty shopping is indeed an issue that may be viewed as contributing to profit shifting, yet the issue here is not one of abuse but rather the appropriate purpose and scope of tax treaties. The United States has been a well-known pioneer (and at times a much-criticized pioneer) in the application of a treaty-based anti-shopping rule, the now well-known limitation on benefits (LOB).[115] The LOB has been a polite revision of the Article 4 residence rules that gave powers to treaty partners (of the United States in this case) to determine effectively domestic residence for corporations on a unilateral basis. The United States was unwilling to concede such power to all of its treaty partners, understanding that some of them serve as willing accommodating jurisdictions for treaty shopping. The United States was unwilling to accept a state of affairs that would have effectively made every treaty "a treaty with the world,"[116] at least as far as investment through corporations was concerned. Yet, the United States wanted to maintain such treaties, and the addition of the

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114. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], PREVENTING THE GRANTING OF TREATY BENEFITS IN INAPPROPRIATE CIRCUMSTANCES, ACTION 6 - 2015 FINAL REPORT (2015) [hereinafter ACTION 6 FINAL REPORT].

115. *See* U.S. MODEL INCOME TAX CONVENTION art. 22 (U.S. DEP'T OF THE TREASURY 2016).

116. *See* TECHNICAL EXPLANATION ACCOMPANYING THE UNITED STATES MODEL INCOME TAX CONVENTION OF NOV. 15, 2006 (U.S. DEP'T OF THE TREASURY 2006), https://www.treasury.gov/press-center/pressreleases/Documents/hp16802.pdf.

LOB was considered a good solution for these combined wishes. It also fit the tax law culture of the United States in its objective façade and through its circumvention of general anti-avoidance rule (GAAR)-type delegations of power to the tax administration.

Action item 6 followed the U.S. example and even recommends a U.S.-style LOB provision in its final report.[117] The report states that LOB provisions are successfully used, yet it does not address their faults and the criticism over some of their features.[118] This recommendation is supplemented by a very different measure: the principle purpose test ("PPT"). PPT reads much like a domestic GAAR and empowers tax authorities to deny treaty benefits to transactions in order to take advantage of the tax benefits of the treaty, unless it is established that the grant of such benefits is in accordance with the object and purpose of the treaty.[119] This provision is fraught with problems, and, most importantly, it may add nothing to tax treaties beyond compliance and enforcement expenses.[120] It is obvious that the focus of this rule is not mere treaty shopping, yet the report does not expand on the reason for this rule beyond its similarity to domestic GAARs. These recommendations are presented in a minimal standard framework (i.e., the OECD expects countries to adopt either one or both of these rules in their treaties).

The striking difference between the LOB and the PPT is obvious. They represent different norms and focuses and they are likely to produce different outcomes. Their marriage here simply has no intellectual basis. The BEPS project acknowledges this through the action item 7 report and anticipates that the PPT will prevent abuse of Article 5(3) by splitting contracts.[121] Any LOB provisions would clearly not cover such abuse, yet it is and should be covered by the commentary and regular interpretation of Article 5(3).

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117. *See* ACTION 6 FINAL REPORT, *supra* note 114.

118. *See* J. Clifton Fleming, *Searching for the Uncertain Rationale Underlying the US Treasury's Anti-treaty Shopping Policy*, 40 INTERTAX 245 (2012).

119. Vienna Convention on the Law of Treaties art. 31, opened for signature May 23, 1969, 1155 U.N.T.S. 331.

120. *See* Michael Lang, *BEPS Action 6: Introducing an Antiabuse Rule in Tax Treaties*, 74 TAX NOTES INT'L 655, 656 (2014).

121. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], PREVENTING THE ARTIFICIAL AVOIDANCE OF PERMANENT ESTABLISHMENT STATUS, ACTION 7 - 2015 FINAL REPORT 44 (2015) [hereinafter ACTION 7 FINAL REPORT].

The current architecture of the report signals a lack of consensus or a compromise that is incompatible with the first insight of BEPS. Perhaps, however, a treaty anti-abuse rule is unnecessary in the first place, and the recommendation(s) pursuant to action item 6 will eventually have no impact on BEPS or the international tax regime.[122]

The report also includes a third recommendation to include a statement about the commitment of the treaty parties to combatting double non-taxation in order to solidify it as a purpose of tax treaties.[123] This proposal was criticized as superfluous as the same could and should be easily interpreted into the treaty. This is true, yet experience shows that what should be done is not always done in the course of treaty interpretation and, therefore, this addition may eventually be helpful.

Finally, the report includes careful language that effectively serves to discourage countries from signing tax treaties with low or no-tax jurisdictions. There are, however, no coordination or implementation aspects for this part. This is an obvious missed opportunity for coordination among the productive countries of the world; yet, it is likely that this part did not garner the necessary political will.

Of course, this action item affects tax treaties and requires the addition of an internal anti-abuse rule(s). It is unclear, in fact doubtful, however, whether it would effectively impact the practice of tax treaty law. This article suggests that it would not do so beyond some countries attempting to use it for aggressive, unprincipled audit practices, which cannot be desirable. Hence, this action item may result in less coordination among countries, not more.

7. Action Item 7: Preventing the Artificial Avoidance of Permanent Establishment Status

The permanent establishment (PE) rules are clearly part of the core architecture of tax treaties.[124] They are also the most important treaty norm adopted by domestic legislation worldwide,

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122. Beyond, perhaps, a standardization of LOB provisions.

123. *See* ACTION 6 FINAL REPORT, *supra* note 114.

124. For an authoritative review of the history and origins of the concept, see ARVID A. SKAAR, PERMANENT ESTABLISHMENT: EROSION OF A TAX TREATY PRINCIPLE (1991).

even if not universally.[125] Yet, the deficiency of the rules has been exposed by changes in the global economy and the thriving of globalization.[126] The key challenge for these rules is presented by the digital economy, yet dealing with that challenge was outsourced to action item 1, with a clear understanding that the OECD would not recommend the inclusion of an innovative digital PE.[127] Nevertheless, many other issues related to the PE rules remained at the top of the international tax regime agenda.[128] Awkwardly, the BEPS project chose to focus on only three issues: one serious, yet fundamental and not necessarily related to BEPS; the second not very serious, resulting from manifestly faulty interpretations of tax treaties by various courts; and the final, important, (if sectoral) application to insurance companies.[129] The final report dealt only with the first two issues, simply stating that the regular rules are sufficient to deal with problems related to insurance arrangements, despite the practical difficulties faced by countries in this regard.[130]

The first issue regards Article 5(4) of the OECD Model and its language as "preparatory or auxiliary." It is argued that this language does not literally apply to all of the circumstances mentioned in this PE "negative list,"[131] leaving a wide window of opportunity for foreign businesses to operate within a jurisdiction

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125. *See, e.g.,* Jacque Sasseville & Arvid A. Skaar (General Reporters), *Is There a Permanent Establishment?*, 94a IFA CAHIERS DE DROIT FISCAL INTERNATIONAL (2009).

126. Indeed, prior to BEPS the OECD had been engaged in a lengthy and comprehensive project to resolve many of these issues. This work resulted in the OECD Model Tax Convention revisions of Article 5. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], OECD MODEL TAX CONVENTION: REVISED PROPOSALS CONCERNING THE INTERPRETATION AND APPLICATION OF ARTICLE 5 (PERMANENT ESTABLISHMENT) (2012–2013), http://www.oecd.org/ctp/treaties/PermanentEstablishment.pdf.

127. ACTION 1 FINAL REPORT, *supra* note 41, at 283.

128. *See* Sasseville & Skaar, *supra* note 125.

129. The rest of the work was explicitly "shelved." *See, e.g.*, Stephanie Soong Johnston, *OECD's Work on Permanent Establishments on Hold for BEPS*, TAX NOTES TODAY (June 4, 2013), http://www.taxnotes.com/beps-expert/corporate-taxation/oecds-work-permanent-establishments-hold-beps/2013/06/05/16715881.

130. *See* ACTION 7 FINAL REPORT, *supra* note 121.

131. Article 5(4) of the OECD Model lists instances that would not constitute PE, and, hence, it is often described as the PE "negative list." *See* OECD MODEL CONVENTION 2010, *supra* note 46, art. 5(4).

without triggering PE taxation. Both the purpose of the negative list and a certain reading of its language requires such an interpretation in the first place, yet the OECD as a representative of the residence states could not make it clear prior to this report. The report recommends changing the Model and Commentary to reflect this interpretation in order to add further clarification in the form of an anti-fragmentation rule. This outcome fits the political background of BEPS and expands source taxation.

The second issue relates to commissionaire arrangements, interpreted under the laws of some countries, by some courts,[132] as not triggering PE for a selling corporation because the selling agent (the commissionaire agent) does not have the authority to conclude contracts on behalf of the principal (the selling corporation). Such authority is required under Article 5(5) of the OECD model. The report clarifies that the policy is to permit PE taxation in a country where sales are affected by agents on a regular basis and implemented by the principal corporation, despite the lack of formal contracting authority. The report shall amend the OECD Model and Commentary to reflect this policy clearly.

Tax treaties are impacted, of course, by these changes to the OECD Model and Commentary, yet most of the changes are essentially clarifications rather than material innovations or realignments of taxing rights. The OECD chose to change the language of the Model rather than just change the commentary, which is the normal practice in cases of clarifications. This should lead to confusion, at least in the short-term. Taxpayers are likely to claim that language changes must have independent meaning and hence cannot be viewed as mere clarifications, despite the OECD rhetoric. This may not carry the day in most courts, yet it will surely be costly for both taxpayers and tax authorities, and coordination is unlikely to be enhanced.

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132. *See, e.g.,* CE, Mar. 31, 2010, Rec. Lebon 304715 (Fr.); Dell Products v. Skatt Øst, HR-2011-02245-A (Dec. 2, 2011) (Nor.); S.T.S., Jan. 11, 2012 (R.J., No. 1626/2008) (Spain); *see also* J. Clifton Fleming, Jr., *A Note on the Zimmer Case and the Concept of Permanent Establishment*, *in* TAX TREATY CASE LAW AROUND THE GLOBE 107 (2011), http://ssrn.com/abstract=2079317.

8. Action Items 8–10: Guidance on Transfer-Pricing Aspects of Intangibles

Transfer pricing, and particularly the arm's length standard that dominates the practice of transfer pricing, is at the very heart of the BEPS project. Aggressive transfer pricing for intangibles was the key component in essentially all of the schemes that triggered the project.[133] The most visible of these schemes relies primarily on the benefits of U.S. cost-sharing regulations that are specific to U.S. tax law.[134] Nonetheless, the application of arm's length to intangibles has never been adequate.[135] It dictates market-based valuation of property (intangible property) that is unique by law or design, and hence very difficult to value.[136] It requires the use of market comparables in circumstances where such comparables or relevant markets simply do not exist. This problem has been known for some time, yet (essentially all) governments, and the OECD, chose not to address the problem and stuck to the arm's length standard without deviation.

The BEPS project had to address it. Its original documents clearly admitted the problem and acknowledged the necessity of deviating from the arm's length standard in certain cases.[137] The final report, as well as prior documents released, indicates that the OECD intends to continue and protect the reliance on arm's

133. *See* Brauner, *supra* note 20, at 41; Kleinbard, *supra* note 90, at 706; Yariv Brauner, *Cost Sharing and the Acrobatics of Arm's Length Taxation,* 38 INTERTAX 554 (2010); Harry Grubert, *Foreign Taxes and the Growing Share of U.S. Multinational Company Income Abroad: Profits, Not Sales, are Being Globalized,* 65 NAT'L TAX J. 247 (2012).

134. *See* Brauner, *supra* note 20, at 41 (referencing Treas. Reg. § 1482-7).

135. It provides inherent, yet implicit, advantages to large, intangible-heavy MNEs. These advantages include the obvious opportunities to engage in tax rates and rules arbitrage and the ability to take advantage of the range of acceptable transfer prices. *See* Yariv Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes,* 28 VA. TAX REV. 79, 161–62 (2008) (explaining that the transfer-pricing rules produce a range of acceptable prices; such range is available only to MNEs—and more so to intangible-extensive MNEs—to minimize their effective taxation unrelated to other tax planning).

136. *Id.*

137. *See* OECD, *supra* note 3, at 42–43.

length for transfer-pricing purposes.[138] The final report posits that the problem is not in the standard itself but rather in the fact that it is prone to abuse, and hence it needs protection, including special measures that may deviate from the standard's direct articulation.[139]

Interestingly, yet reasonably, the OECD introduced a principle in this context—a principle that requires profits to follow real income generation activity or "value creation" in the language of BEPS. It is interesting since such a principle does not obviously correspond to the market-based arm's length standard. Value creation may or may not be perfectly reflected in prices. Nonetheless, the report presumes that the value-creation principle is not an innovation but merely the correct interpretation of the arm's length standard. The implication of this approach is a revision of the transfer pricing guidelines ("TPG")[140] to require profit allocation, based on arm's length methodology, only to value-creating activities and to disregard activities that do not make business sense or are not contributing to the creation of value for the taxpayer.

A complementary statement would be the rejection of profit allocation based on mere legal ownership of an intangible good. This is BEPS compatible and should be lauded, but the real test would be whether it could be implemented and how courts would react when this approach conflicts with traditional, literal arm's length jurisprudence.[141] Moreover, even if the value creation principle is vague, it is unlikely to permit taxation by source countries solely based on their being the target, or the market for the tested goods and services. This is relevant for transfer-pricing claims based on market facilities rather than value creation, and even for claims by developing countries for extra allocations based on locational savings.

A similar conflict would arise in the context of action item 1 if a nexus-based approach were to be taken. Note that there is no

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138. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], ALIGNING TRANSFER PRICING OUTCOMES WITH VALUE CREATION, ACTIONS 8–10 - 2015 FINAL REPORTS (2015) [hereinafter ACTIONS 8–10 FINAL REPORTS].

139. *Id.*

140. *Id.*

141. *See, e.g.*, Jens Wittendorff, *BEPS Actions 8–10: Birth of a New Arm's Length Principle*, 81 TAX NOTES INT'L 331 (2016). Also note that prior U.S. experience was not very promising in this regard. For example, see the Veritas and Altera decisions and analysis. *See* Michael L. Schler, *The Arm's-Length Standard After Altera and BEPS*, 149 TAX NOTES 1149 (2015).

right or wrong here. It is merely part of the renegotiation of the tax-base division deal. Yet, the current system, which is coordinated with the value-creation principle, attempts to base the deal on supposed economic truth. This must be unsustainable; it may be possible to reach compromises, or force legitimacy based on the pseudoeconomic justifications for the current rules, but not to actually justify them in any coherent and comprehensive manner. Moreover, once countries such as China and India agree to the value-creation rhetoric they would find themselves in a problematic position of seeking enhanced tax jurisdiction based on parameters other than value creation. The disagreement over the meaning of the term was not resolved by the final report, and hence no progress was made on the important aspect of revenue division under the international tax regime.

A second transfer-pricing rule established by the report is the limitation on the allocation of profits to risk-taking. Originally, this part of the work, using a pure tax-haven cash-box example to demonstrate inappropriate planning, purported to disallow allocation of profits to mere cash investors.[142] The final report establishes a softer rule that permits risk-taking to be taken into account only when the relevant taxpayer has the capacity to both meaningfully control and assume the risk. It remains to be seen how much abuse this softer rule will prevent beyond the most egregious of cases. The prohibition on assignment of profits beyond risk-free returns on cash-only contributions remains part of the report, which is desirable, yet it is not clear whether it would practically apply also in situations where the taxpayer can establish minimal contribution beyond cash for the cash box, low-tax entity.

The report promotes the profit split method in a move that has been in the making for a long time now.[143] Yet, the content of this promotion was left for the post-BEPS era (i.e., probably for an OECD-only forum). It further provides that synergistic value will have to be allocated according to the parties' contribution to such values.[144] This part of the report is awkward since synergies are not really a result of one contribution or another. Again, it is difficult to see how such a rule would affect tax planning.

142. *See* ACTIONS 8–10 FINAL REPORTS, *supra* note 138.
143. *Id.*
144. *Id.*

In conclusion, the impact of the action items 8–10 final report on tax treaties is likely to be minimal beyond the amendments it introduces to the TPG. If widely adopted, the changes to the TPG may end up having a minimal impact, preventing only the most aggressive and extreme cases, such as pure cash boxes. It does not alleviate the difficulties of intangible valuation, and does not provide concrete steps in the direction of deviations from arm's length in necessary cases. The only immediate effect is perhaps the maintenance of OECD dominance over the TPG, which is deferred to regularly by many countries' courts. This continuous shift of power from governments of non-OECD countries to the OECD as an institution may, however, be resisted again, with the likely consequence of less, not more coordination among jurisdictions regarding their most important tax policies.

It remains to be seen how significant the introduction of the value-creation principle itself will be. If many countries follow it strictly, it may significantly alter the practice of transfer pricing (albeit one should then expect serious variation in the implementation of this principle because BEPS does not provide guidance in the area). A more realistic outcome would be that it would have a minimal impact solely on the transfer-pricing practice due to the strong commitment of governments and their courts to literal arm's length and the comfort that the business community already has acquired with this state of affairs. This likely outcome should be viewed as the biggest disappointment of the BEPS project and presents the most conservative outcome in the area most in need of reform and innovation.

9. Action Item 11: Measuring and Monitoring BEPS

Action item 11 begins the "administrative" part of the BEPS action plan, following action items 1–10 that address substantive, tax-base dividing, norms of the international tax regime. Preceding the entire BEPS project, one should have asked the question: "Is BEPS a problem in a perfect world?" Yet, as mentioned already, BEPS is essentially a political rather than a scientific project. It was launched based on anecdotal data and public outrage rather than facts and analysis. Action item 11 intends to remedy this deficiency and help the project to assess the magnitude of the problem and monitor it, including the impact of the project's solutions to the BEPS problem over time.

The final report on action item 11 is not final, as it is charged with establishing an ongoing measurement and monitoring platform, yet it confirms the negative impacts of BEPS, primarily due to inefficiencies (economic distortions) and revenue losses, which disproportionally are suffered by developing countries.[145] The report further asserts that BEPS is significant and is likely to increase.[146] It notes, however, that its conclusions are severely limited by the scarcity and quality of data available. The report, therefore, sets the stage for the increased collection of better data that will permit a thorough assessment of BEPS in the future.

This action item does not have a direct impact on tax treaties or policy in general. Additionally, it is beyond the scope of this article to analyze the methodology used by the reporters. Yet, an educated study of the impact of international tax norms and the greater collection of better data must be welcomed. Accountability should be part of every policy action, yet so often it is ignored, so the work on this action item must be lauded. One may raise concern, however, about the opportunities it would present to the more powerful to abuse the less powerful, but that situation could not be worse post-BEPS in comparison to the pre-BEPS era.

10. Action Item 12: Mandatory Disclosure Rules

Perhaps the least discussed BEPS action item, action item 12, presents a framework for countries that wish to adopt rules for mandatory disclosure of aggressive tax positions by taxpayers. In the language of the final report, the framework is presented as, but is not required to be, a minimum standard.[147] The purpose of a mandatory disclosure regime is to improve awareness of tax-planning techniques for tax authorities, to increase transparency in tax planning, and to deter both taxpayers and promoters. Its benefits must be weighed against its costs.

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145. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], MEASURING AND MONITORING BEPS, ACTION 11 - 2015 FINAL REPORT (2015) [hereinafter ACTION 11 FINAL REPORT].

146. *Id.* at 16.

147. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], MANDATORY DISCLOSURE RULES, ACTION 12 - 2015 FINAL REPORT 13 (2015) [hereinafter ACTION 12 FINAL REPORT].

The appeal of such regimes in the context of BEPS is understandable, and it fits well among the other transparency-enhancing measures, yet the experience of countries already utilizing them is not very encouraging.[148] The key issue is which transactions require reporting, a determination that dynamically affects inappropriate tax planning as well as tax planning generally. Thus, the lack of enthusiasm over this action item is understandable as well. Ultimately, this action item does not affect tax treaties.

11. Action Item 13: Guidance on Transfer-Pricing Documentation and Country-by-Country Reporting

The most tangible achievement of BEPS, and perhaps its only real contribution to the evolution of the international tax regime, is the introduction of standard transfer-pricing documentation and Country-by-Country ("CbC") reporting. Transfer-pricing regulation intends to keep MNEs in check, requiring them to establish transfer prices based on arm's length (i.e., market) analysis and document their position contemporaneously.[149] The documentation requirement fixes the taxpayers' positions and limits their options. Despite the inherent bilateral (or multilateral) nature of transfer prices, the rules and reporting apply on a unilateral basis with no coordination or a strong requirement of consistency. This is strange in a regime that applies an essentially universal standard to multiple countries in parallel to the same transactions.

Action item 13 seeks to fix some aspects of this anomaly by standardizing the documentation requirements. The final report establishes a three-tier reporting regime.[150] A master file includes information that would be necessary for the implementation of the rules in every relevant country.[151] A standard form

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148. For the U.S. Rules, see Todd C. Simmens & James G. Hartford, *Reportable Transactions*, 648-1st Tax Mgmt. (BNA), U.S. Income, https://www.bloomberglaw.com/document/2657753640 (last visited Oct. 1, 2016). A similar Brazilian experience has also not been noted. *See, e.g.*, Mesa De Debates Do IBDT De 10/15/2015 (Oct. 15, 2015) (unpublished manuscript) (on file with author).

149. *See, e.g.*, *supra* note 136.

150. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], TRANSFER PRICING DOCUMENTATION AND COUNTRY-BY-COUNTRY REPORTING, ACTION 13 - 2015 FINAL REPORT 9 (2015) [hereinafter ACTION 13 FINAL REPORT].

151. *Id.* at 25.

avoids duplication, and hence reduces the costs of compliance and prevents inconsistent reporting. A country file complements the master file with more particular information that may be relevant to specific countries or, for legitimate reasons, information uniquely required by one involved country but not by another.[152] Finally, a standard CbC report provides an overview of the entire business of the taxpayer in the different relevant countries in order to give individual countries a better perspective on the specific country reporting information relevant to them and how it fits the general structure and strategy of the taxpayer.[153] Such reporting also encourages consistency in compliance and filing.

This standard three-tier reporting should improve the consistency of transfer-pricing compliance, which one would expect to be inherent of this norm, yet has been neglected in the current competition-based international tax regime. It would obviously be consistent with the single tax principle or, more pointedly, would assist in avoiding untaxed "gaps" in income reporting because of inconsistent transfer-pricing positions. It would reduce the costs of compliance and enforcement, especially for countries with insufficient budgets for sophisticated enforcement of transfer pricing. It would prevent biased reporting either due to taxpayers' interests or power positions of certain countries. Finally, it would centralize the control over the transfer-pricing regime and, therefore, set the stage for opportunities for coordination of policies and enforcement.

The CbC report is the single true innovation of BEPS today. Yet, the conservative forces within the project have fought to diminish its scope, supposedly in the name of protecting taxpayers' data.[154] Whether corporate tax data should be confidential at all

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152. *Id.* at 27.

153. *Id.* at 29.

154. Compare with the original discussion draft. ORG. FOR ECON. CO-OPERATION & DEV. [OECD], DISCUSSION DRAFT ON TRANSFER PRICING DOCUMENTATION AND CBC REPORTING (2014), https://www.oecd.org/tax/transfer-pricing/discussion-draft-transfer-pricing-documentation.pdf; *see also* Lee Sheppard, *OECD BEPS Country-by-Country Reporting is Too Burdensome, HMRC Official Says*, TAX NOTES TODAY (Feb. 11, 2014), http://www.taxnotes.com/tax-notes-today/corporate-taxation/beps-seen-area-both-consensus-and-conflict/2013/09/19/41796 (quoting opposition expressed by a U.K. official to the discussion draft, claiming that it goes too far and requires reporting of information that is not obviously necessary for effective tax

is beyond the scope of this article, yet it is clear that the conservative forces have succeeded in significantly limiting the scope of the CbC report to information that is generally already available or could be available to most sophisticated, well-funded tax authorities. Moreover, the same forces dictated that the report should only be available to the tax authorities to keep the information confidential.[155] Finally, the same forces succeeded in adding a clarification that the CbC report would not directly be used for tax assessment but only for risk assessment purposes (i.e., to identify problems).[156] Such clarification aims primarily at the prevention of deviation from arm's length and resorts to formulary apportionment.[157] The structure of the CbC report is particularly amenable to formulary taxation that has been consistently rejected, at least rhetorically, by the OECD. The very resort to such a report demonstrates the necessity of formulary apportionment for a sensible enforcement of income taxes on MNEs.

The actual implementation of the action item 13 reports will likely be the major test for the future impact of BEPS. The impact on tax treaties is indirect since the reports would not change the substance of tax treaties, but would make transfer-pricing consistency necessarily better, which would reduce the

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audits, which is very much in line with the traditional OECD competition-based approach).

155. For arguments in favor of confidentiality, see ACTION 13 FINAL REPORT, *supra* note 150, at 19, 22; David Ernick, *Will Public Disclosure of Country-by-Country Reporting Data Become Mandatory?*, 44 TAX MGMT. INT'L J. 362 (2015). *But see Communication from the Commission to the European Parliament and the Council on Tax Transparency to Fight Tax Evasion and Avoidance*, COM (2015) 136 final (Mar. 18, 2015), http://ec.europa.eu/taxation_customs/resources/documents/taxation/company_tax/transparency/com_2015_136_en.pdf (EU proposal to mandate public disclosure of such tax information).

156. *See* ACTION 13 FINAL REPORT, *supra* note 150, at 16.

157. For an example of a proposal to adopt formulary taxation of business profits more generally, see Reuven S. Avi-Yonah & Kimberly Clausing, *Reforming Corporate Taxation in the Global Economy: A Proposal to Adopt Formulary Apportionment*, *in* PATH TO PROSPERITY: HAMILTON PROJECT IDEAS ON INCOME SECURITY, EDUCATION, AND TAXES 319–44 (Jason Furman & Jason Bordoff eds., 2007); *see also* Reuven S. Avi-Yonah & Ilan Benshalom, *Formulary Apportionment: Myths and Prospects - Promoting Better International Tax Policy and Utilizing the Misunderstood and Under-Theorized Formulary Alternative* (Univ. of Mich. Law Sch., Pub. Law & Legal Theory Research Paper Series, Working Paper No. 221, 2010), http://ssrn.com/abstract=1693105.

inefficiency of treaties and enhance international coordination of tax policies and enforcement.

Note, however, that the failure to establish a cooperative environment within the BEPS project may make action item 13 the biggest disappointment to OECD conservatives. Few share the illusion that CbC reports can be kept confidential and that they would be used merely for risk assessment purposes. Think about the many developing countries that struggle to collect revenue from MNEs, that struggle to finance their revenue authorities adequately, and that may resent the most developed countries for not yielding more taxing rights to them. Now these authorities are going to obtain official reports that provide a simple map for taxation by formula cheaply, or at no cost. Unless quick action toward coordination is taken post-BEPS, the logical prediction is that such tax authorities will more likely than not use the transfer-pricing reports in manners other than those prescribed by the OECD.

12. Action Item 14: Making Dispute Resolution Mechanisms More Effective

An international legal regime is often measured by the efficacy of its dispute resolution regime. The current, soft, non-legalistic mutual agreement procedure ("MAP") regime has undoubtedly been proven successful for the forming years of the regime. Its non-mandatory nature reduced the perceived threat posed by the international tax regime to the tax sovereignty of the participating nations.[158] It also has not prevented the convergence of the international tax rules, despite not having contributed much to their development. Many fundamental disputes have actually been resolved without resort to tax wars, a non-trivial achievement indeed. Yet, in recent years, it became increasingly apparent that progress is required. A quicker, cheaper, and more decisive regime is needed. Scarcity of revenue, increased competition for investment, globalization, and decentralization of power,

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158. *See*, *e.g.*, Robert A. Green, *Antilegalistic Approaches to Resolving Disputes Between Governments: A Comparison of the International Tax and Trade Regimes*, 23 YALE J. INT'L L. 79 (1998).

and the increasing complexity and sophistication of global business requires a more resolute regime that would contribute rather than just adhere to the universal norms.[159]

The pre-BEPS OECD project has resulted in a recommendation for mandatory "baseball" arbitration to be added to the MAP in cases that the latter fails to resolve in an acceptable timeframe.[160] Some countries have adopted this recommendation, yet despite the relative success that the solution apparently enjoys, only a few treaties were concluded based on this recommendation.[161] This failure exacerbated BEPS on the one hand and the unjust treatment of some taxpayers—who could not get relief—on the other hand. Afterwards, the BEPS project made another attempt and employed its first insight to organize a relatively large, yet incomplete, group of countries that now commit to adoption of mandatory arbitration in all of their treaties.[162]

Success in adopting a multilateral instrument of the kind described next may prove to be important for a chance of success in realizing such commitment. Yet, all the evidence leads to a conclusion that most countries simply do not trust the OECD and its leading members to establish a fair arbitration process. They further believe that qualified arbitrators will likely come predominantly from such OECD countries and, hence, disadvantage them in the process. Nothing was done in the work on action item 14 to resolve this fundamental problem and ensure wide and willing cooperation. There is no reason to believe that progress will be made until such effort is made in earnest. This action item does not affect the substance of tax treaties, and is not even new to the OECD Model, yet it is obviously very important for the future of tax treaties as effective building blocks of the international tax regime. This future may be in doubt if it is not realized.

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159. *See* ORG. FOR ECON. CO-OPERATION & DEV. [OECD], IMPROVING THE RESOLUTION OF TAX TREATY DISPUTES (2007), http://www.oecd.org/ctp/dispute/38055311.pdf.

160. *Id.*

161. *See* ACTION 14 FINAL REPORT, *supra* note 31.

162. Encouragingly, the OECD notes that these countries were involved in 90 percent of outstanding MAP cases at the end of 2013. *Id.* at 10. None of these countries, however, represents a developing or an emerging economy.

13. Action Item 15: Developing a Multilateral Instrument to Modify Bilateral Tax Treaties

Enhanced coordination of tax laws and policies is the key insight of the BEPS project: countries are now unable to apply unilaterally their tax system, independent of all other countries. The intuitive notion of national sovereignty at its most fundamental level—tax policymaking, collection, and enforcement—has brutally crashed. Even the strongest countries in the world find themselves vulnerable. Thus, agreeing to a multilateral solution against this backdrop became inevitable. Action item 15 was charged, therefore, in assessing the feasibility of adopting such an instrument. Despite the long-standing opposition of many countries and experts to the notion, the action item 15 report clarifies that such an instrument is both legally and practically feasible.[163] This is dramatic enough, yet the report exceeds its mandate merely to issue a report and proceeds to work on the implementation of the instrument.[164]

The final action item 15 report uses language consistent with the minimal view of BEPS to promote the adoption of the multilateral instrument.[165] It explains that to be effective the BEPS recommendations must be implemented quickly, cheaply, and coherently in a synchronized manner. This is impossible in the current paradigm of pure bilateral negotiation and conclusion of tax treaties. The BEPS project took advantage of its political support to conclude that its charge could only be met if such an instrument is adopted. This perceived instrument does change the bilateral nature of tax treaties and streamlines standard amendments to tax treaties, such as those required by BEPS. It also prevents the elaborate give-and-take nature of bilateral treaty negotiations and their budget constraints from being obstacles in realizing these goals.

Additionally, the report realizes the possibility of partial or gradual adoption of the multilateral instrument.[166] Such flexibility makes the instrument more appealing (or less intimidating) and most importantly sidesteps the all-or-nothing approach that so typified the debate over multilateralism in taxation. Naturally, the success of the instrument will depend on the size of

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163. ACTION 15 FINAL REPORT, *supra* note 83.
164. *Id.*
165. *Id.* at 16.
166. As previously argued by Brauner. *See* Brauner, *supra* note 12, at 262.

its early adopters. The devil here is truly in the details. How will the instrument work if countries begin to demand items not agreed on within the BEPS project? How will consensus be achieved with many diverse countries with different interests involved? Many such questions leave this welcome development with an unclear future. Ultimately, this action item does not immediately affect the substance of tax treaties, yet it may revolutionize tax treaty law and practice and guarantee their continuous importance for the international tax regime.

B. The Impact of the BEPS Project on Tax Treaty Law

The conclusion of the BEPS project provides an opportunity to assess its impact on the international tax regime. This section focuses on the tax treaty implications. For the purposes of this analysis, it is assumed that the recommendations of the BEPS project would generally be adopted.

First, very few substantive norms in tax treaties will be impacted by BEPS. The already ineffective tie-breaking rule for corporate residence in Article 4(3) would be replaced with a facts-and-circumstances no-rule. The clarification to Article 5(4) and the corresponding anti-fragmentation rule are just that—clarifications that could have been achieved through better interpretation of the provision. Similarly, the clarification on commissionaire arrangements simply corrects inappropriate interpretations of Article 5(5) by some courts. The only other potentially substantive change may be the insertion of a digital PE provision in treaties or a similar provision targeting the taxation of the digital economy. Such a change has not yet been recommended (nor has it been outright rejected), but, unlike these other minor changes, it would actually alter the tax base division in some circumstances. Otherwise, no changes in the division of tax bases are affected by BEPS, which must be viewed as at least a short-term achievement for the OECD. However, it is difficult to see how the developing world could stomach such an outcome.

The changes to the TPG cannot be viewed as substantive changes to tax treaty rules since the treaties are vaguely the source, if any, of the legal obligation to adhere to the TPG. Nonetheless, the intimate relationship between tax treaties and the TPG make their discussion relevant to the general assessment of the impact of BEPS on tax treaties. It is possible, however, to argue that the substantive impact of BEPS on transfer pricing

is not dramatic. Pure cash boxes are going to be difficult to justify, business activities will probably[167] matter more than risks, and profit split will continue to be the star of the show (together with the comparable pricing model and the transactional net margin method), even though the details regarding profit split are left for the post-BEPS era.

A careful assessment should, however, be more patient and acknowledge that these changes, together with the infusion of the value-creation principle and the completely new standard reporting systems, may be more impactful on the practice of transfer pricing. This is true if the OECD is successful and the changes are properly enforced and coordinated among jurisdictions. But, it would also be meaningful if the changes are unpopular, in which case massive litigation and double taxation are the likely result, which would put immense pressure on countries to revisit coordination.

Yet, one cannot avoid expressing a disappointment at these achievements. No fundamental reform occurred, and mostly it seemed that the OECD was more interested in declaring success than reforming the regime. This of course may be the fault of political forces, not the staff of the BEPS project, yet the bottom line is the same. This is particularly disappointing in light of the original promise of BEPS to innovate and address situations where arm's length had failed to do the trick. The BEPS project neglected to follow this promise. The addition of a treaty anti-abuse mechanism is itself a change of the model convention and not a change of the tax-base division rules. This change is not likely to be so dramatic since LOB provisions already exist in tax treaties and PPT provisions are unlikely to have much impact, even if adopted in actual tax treaties.

The service part of BEPS promises to make a much stronger impact on tax treaties. First and foremost, the multinational instrument could revolutionize tax treaty law. Even if its implementation stalls for a while, the conclusion about its feasibility transforms the discourse from the all-or-nothing binary choice between the current regime and a world tax government to a more serious discourse on possible evolution of the regime and a better understanding of tax treaties. If one takes the view of tax

167. Albeit, the report depends on familiar concepts such as nexus and substance and such may raise the suspicion that not much would indeed change in this regard.

treaties as signals, supported by this article, he or she would observe that the potential future regime is also better suited for the true nature of tax treaties.

Second, but in many ways as important, is the progress made toward reform of the dispute resolution mechanism, and the addition of mandatory arbitration provisions to many more tax treaties. Mandatory arbitration is not a BEPS innovation, yet its adoption has been very slow and inconsistent to date. A pact among many powerful countries would provide a huge step forward and would add meaningful treaty-based dispute resolution to the international tax regime.

Third, BEPS introduced the important innovation of standard transfer-pricing reporting, yet, as already mentioned, this is not strictly treaty related. That again would significantly improve the coordination value of tax treaties and would make their operation more effective and hopefully more just. Finally, the other information collection aspects of BEPS would similarly add to the efficacy of the regime and of tax treaties (not to mention their contribution to the study of tax treaties).

In conclusion, the impact of BEPS on tax treaties is generally small, yet the structural, service elements present a promise of a much more significant reform of tax treaties and the international regime. Since most of these elements do not include concrete and immediate reforms of the norms, it is difficult to predict their actual impact.

C. BEPS, the International Tax Regime, and Enhanced Coordination

A similar, more indirect impact of BEPS on tax treaties may be its impact on the international tax regime beyond tax treaty law. The non-tax treaty reforms dwarf the above-discussed changes to tax treaties. The bulk of the work of the BEPS project focused on changes to domestic laws in the general format of best practices. The idea was that such best practices would eventually be adopted universally with little changes to enhance the standardization of the norms of the international tax regime, which would eliminate stateless income and the prevention of BEPS. These key reforms include the anti-hybrid-planning norm recommended by the action item 2 report, the introduction of standard CFC regimes, a standard limit on interest deduction, a limitation on preferential regimes in general and patent boxes

in particular, the revised TPG, and a self-reporting mechanism for aggressive tax planning.

It is difficult to find a coherent policy that would unite all of these changes beyond simplistic anti-BEPS measures. Yet, a common thread does exist: they all operate in a manner that requires or enhances coordination in the international tax regime. This is interesting since, as coordination devices, these are all at least second-best measures because they are soft law. Yet, one can make a valid argument that this is the best that the OECD could politically achieve in the direction of enhanced coordination. Perhaps countries do not fully comprehend the first insight of BEPS. A discussion about the soundness of this argument is beyond the scope of this article and may be fruitless in any event. One may criticize the tactics and strategy of BEPS, the OECD, and the various participants, yet, at the same time, one should also be realistic about the achievements of the project.

The overall progress toward enhanced coordination of tax policies and practices indirectly influences tax treaties as a part of the more general international tax regime. This article concludes that the emphasis on domestic law changes was perhaps misguided, yet, in the end, it has not altered the balance in the regime toward neglect of tax treaties as critical building blocks of the regime. The most important non-treaty effect of BEPS, however, is not legal. It is the change in the compliance and enforcement environment across the globe. Taxpayers face a tsunami of uncertainty and a serious threat to the rule of law in tax matters. One may view these changes as beneficial—perhaps as a price to pay for BEPS—yet the threat that this scenario poses to the stability of the international tax regime, and even to global investment, is quite serious. Again, the one clear outcome of BEPS is that it decimated rather than enhanced international cooperation and coordination of tax policies. The question becomes whether this outcome is just temporary, setting up a desirable and meaningful reform, or just a first step toward the dismantling of the (tax treaty based) international tax regime as we know it.

III. THE FUTURE OF TAX TREATIES

This part will address the future of tax treaties in light of the analysis of the impact of BEPS on tax treaties and the international tax regime. These are interesting times for tax treaties. As the BEPS project winds down there is little finality as to its

impact on tax treaties or otherwise. The BEPS proposals for amendments to the OECD Model promise minimal impact (at best) as well. Yet, perhaps the "fog of war" obscures some material developments that may be very meaningful for the future of tax treaties. The following sections will analyze some of these potential developments.

A. The Institutional Dimension

The institutional dimension of the international tax regime is critically important for any analysis of tax treaties. The lack of current institutionalization of the regime fits its soft law essence, its flexibility, and resilience. Yet, largely, the OECD has served as a forum for international tax policymaking.[168] The role of the OECD has been particularly significant for the centrality of tax treaties, them being largely modeled after the OECD Model.[169] Such role was left essentially unchallenged.[170]

All of the other potential players have not even entered the match. The United Nations effectively has abandoned its tax treaty project and, when it recently resumed the project, it preferred to position itself as complementary to the OECD rather than a contestant for leadership.[171] The World Trade Organization (WTO) escaped responsibility in taxation and has never gained expertise in the field.[172] An independent tax forum, alt-

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168. *See* Brauner, *supra* note 12, at 310–16; Arthur J. Cockfield, *The Rise of the OECD as Informal 'World Tax Organization' Through National Responses to E-commerce Tax Challenges*, 8 YALE J.L. & TECH. 136 (2006).

169. *See* THE IMPACT OF THE OECD AND UN MODEL CONVENTIONS ON BILATERAL TAX TREATIES, *supra* note 2.

170. The United Nations tax project, although nominally a competing initiative with its own model convention, has never presented itself as an alternative and has never been one.

171. *See* THE IMPACT OF THE OECD AND UN MODEL CONVENTIONS ON BILATERAL TAX TREATIES, *supra* note 2; Wim Wijnen & Jan de Goede, *The UN Model in Practice 1997–2013*, 68 BULL. FOR INT'L TAX. 118 (2014), http://www.un.org/esa/ffd/wp-content/uploads/2014/11/9STM_FinalPublishedVersionIBFD.pdf.

172. *See* Brauner, *supra* note 12, at 315–16; *see also* Reuven Avi-Yonah & Joel Slemrod, *(How) Should Trade Agreements Deal with Income Tax Issues?*, 55 TAX L. REV. 533 (2002) (contemplating the possibility of the WTO as also encompassing an international tax agreement and promoter of it).

hough proposed from time to time, was shot down as unreasonable because it was painted with the unappealing colors of a world tax government.[173]

Interestingly, the G20 has entered the picture, which provides political legitimacy and backing for the BEPS project. For a while, the more exclusive G8 (now the G7) organization attempted to highjack the project but failed.[174] The G20 includes the largest, but not the richest economies of the world, representing both OECD and non-OECD members.[175] Its involvement clearly challenges the OECD that had dominated the international tax regime, at least until recently.[176] Yet, such challenge may also be viewed otherwise—a convenient role for the OECD as caretaker of the international tax regime.

First, the OECD is charged with the actual management and implementation of the BEPS project, keeping it in the dominant position, and precluding an independent development of expertise elsewhere (even the G20 is currently unequipped for that). Second, the OECD is able to position itself as a partner rather than an agent for the G20 in the BEPS project.[177] This is particularly striking in light of the fact that BEPS is a response to failures of the current OECD-led international tax regime. Third, the partnership with the G20 relieves much of the pressure on the OECD to give a voice to non-OECD members, especially emerging economies with strong positions in the world markets like China and India. As already mentioned, the OECD attempted to relieve some of this pressure by granting observation privileges to developing countries and involving them in the discourse, yet that has not been enough. These countries demanded a real voice (voting powers) and actual changes in the norms. The partnership with the G20 permits some acceptance

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173. *See, e.g.*, Horner, *supra* note 21.

174. *See* Prime Minister's Office & Cabinet Office, *G8 Factsheet: Tax*, GOV.UK (June 7, 2013), https://www.gov.uk/government/publications/g8-factsheet-tax/g8-factsheet-tax.

175. *See*, *e.g.*, *G20 Members*, G20.ORG, http://g20.org.tr/about-g20/g20-members/ (last visited Apr. 7, 2016).

176. *See*, *e.g.*, Herzfeld, *supra* note 47; Grinberg, *supra* note 49.

177. Throughout the BEPS documents the OECD presents itself as a partner "on equal footing" with the G20. *See, e.g.*, OECD, ACTION PLAN ON BASE EROSION AND PROFIT SHIFTING, *supra* note 5, at 25.

of these demands without a significant effective concession of power by the OECD itself.

Finally, partnering with leading developing countries assists the resolution of some fundamental conflicts that may not have been possible to resolve within the OECD. In an all-OECD forum, it would be difficult to consider concessions to source countries on a unilateral basis, but in such larger forums, politicians could explain such concessions. This latter advantage was very apparent since collaborating with the G20 is not new for the OECD. The establishment of the Global Forum had similar origins, albeit in a more limited scope.[178] The relative success of the Global Forum, coupled with the preservation of the influence of the OECD over it, perhaps made the OECD particularly comfortable with this arrangement.

Against this backdrop, one should predict that the OECD will be successful in keeping much of its dominant position over the international tax regime after BEPS. This means that one should not expect dramatic changes in tax treaties, but rather a slow-paced, gradual, and mostly predictable refocusing of the tax base division, probably in the direction of more deference to source taxation. This article largely agrees with such a prediction, yet it would add that a paradigm shift toward enhanced coordination would require changes that may be more significant than predicted. Some of these changes would align with OECD policies, and some would not.

A word of caution is due here regarding the role of the G20 in the process. It may be tempting to make the argument that the power within the international tax regime is shifting from the OECD to the G20.[179] The latter is in charge of BEPS and its adoption politically. It is quite clear that the OECD alone cannot proceed with any meaningful policy reforms related to the international tax regime without some key G20 members, especially China and India. Moreover, parallels between the BEPS project and the Global Forum, for instance, may be viewed as a shift toward the way "things are done" by the G20, especially when coupled with the developments in the Global Forum and other international actions taken by the G20.[180]

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178. *See* Grinberg, *supra* note 49.
179. *See id.*
180. *See id.*

Yet, one should realize that the G20 is a very different organization from the OECD. G20 goals (global financial stability) are more limited to begin with.[181] It does not compare to the size and expertise of the OECD personnel (as far as taxation is concerned). It is an umbrella political organization with little independent institutional power and lacks a permanent secretariat or even a headquarters. The revolving leadership of the organization also affects the ever-changing agenda that is strongly related to the agenda of the host and chairing country. Interestingly (and convincingly), prominent scholars have argued that the OECD effectively serves as the secretariat for the G20.[182] Therefore, the conclusion that the G20 is not about to take over from the OECD and change the international tax regime stands.

The more interesting question is what position key G20 members (such as the BRICS nations) will hold in the discourse with the OECD over post-BEPS developments in the regime. The answer is difficult to predict accurately, of course, but, as analyzed elsewhere, it is both desirable and likely that the OECD will need to be more inclusive and flexible if it wishes to preserve the international tax regime.[183] An informal initiative, such as the one run for the BEPS project with the support of the G20, provides a comfortable environment for the OECD. If the OECD can sustain it, it probably will. This may be more difficult when "new" or other non-BEPS conflicts come up. At that point in time, a more institutionalized, yet similar, forum for international tax coordination is likely to be a natural progression from the *ad hoc* BEPS project partnership between the OECD and the G20.

So, what could change? The real question is whether any kind of an international tax forum can arise post-BEPS. Note that the BEPS project itself should not be considered as such since the OECD governs it alone (even if it is endorsed loosely by the G20). Very recently, the OECD published a call for the establishment

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181. *See id.*

182. *See* Jan Wouters & Sven Van Kerckhoven, *The OECD and the G20: An Ever Closer Relationship?*, 43 GEO. WASH. INT'L L. REV. 345 (2011).

183. *See* Reuven Avi-Yonah, *A Perspective of Supra-Nationality in Tax Law*, *in* BRICS AND THE EMERGENCE OF INTERNATIONAL TAX COORDINATION 33–38 (Yariv Brauner & Pasquale Pistone eds., 2015).

of a new forum for the implementation of the BEPS project.[184] Interestingly, this call came a few months after the conclusion of the BEPS project, not as a direct continuation of BEPS and with little anchoring in the final stages of the BEPS project. The OECD alone called all countries, not just the G20, to join it in this forum. It said that the OECD shall present the forum to the G20 in 2016 as a natural part of an ongoing partnership between the two organizations. This is an interesting development and one that was a long time coming, despite being resisted until now by the OECD.[185] It fits the BEPS agenda and its insights, even if the actual project has violated such insights. Viewed simply, it is just the OECD understanding that it could achieve nothing or close to nothing by acting alone. Yet, such a move also keeps the OECD at the helm and blocks anyone else from leading a parallel initiative.

Furthermore, the creation of such a forum also fits two other major BEPS developments, regarding action items 14 and 15. BEPS calls for arbitration, which requires a new forum to better promote its success. By the end of the project, only twenty rich countries joined, and that will not be sufficient. The new forum will present an opportunity to convince other countries to join and to break deals that would have a similar effect. More importantly, the implementation of the multilateral instrument would require a separate forum already created by the OECD,[186] and largely controlled by it, yet some OECD countries (most importantly the United States) are still not on board. This leaves the OECD and its members vulnerable in a crucial forum that includes many countries that do not necessarily have interests aligned with that of the OECD.

The combination of the forums would give the OECD more power and would hopefully convince the United States to join, especially if arbitration would be part of the deal brokered because it is the most important goal of the United States with respect to BEPS. Additionally, the OECD must understand that

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184. *All Interested Countries and Jurisdictions to be Invited to Join Global Efforts Led by the OECD and G20 to Close International Tax Loopholes*, OECD.ORG (Feb. 23, 2016), http://www.oecd.org/tax/all-interested-countries-and-jurisdictions-to-be-invited-to-join-global-efforts-led-by-the-oecd-and-g20-to-close-international-tax-loopholes.htm.

185. *See* Brauner, *supra* note 12.

186. *See* ACTION 14 FINAL REPORT, *supra* note 31, at 37–41.

the combination would also be important since it is unlikely that once a multilateral instrument is established, if indeed it is successfully established, it would be used solely to implement BEPS according to OECD prescription. Such an instrument will have to be the basis for a new international tax regime and, itself, an international tax forum. It would be crucial for the OECD to gain control over such a forum from the beginning when it still holds all the cards.[187]

B. Enhanced Coordination

One of the primary weaknesses of the BEPS project has been its lack of a clear identity. From the beginning, it suffered from a duality of purposes. On the one hand it wanted to reform the international tax regime, bringing it into the twenty-first century, yet on the other hand much of it was limited to the pursuit of specific, limited (even if major in impact) tax-planning schemes. The latter, minimalist view of the BEPS project dominated throughout, perhaps due to the unreasonably tight schedule dictated. Yet, it quite obviously conflicted with the first insight of BEPS that identified the necessity of enhanced coordination. Coordination is a problem since it conflicts with the very nature of our competition-based regime.

As already explained, much of the actual BEPS deliverables, and clearly the immediate impact of the project, should be attributed to its minimalist view.[188] Nonetheless, some of the action items individually reflected the maximalist, reform-seeking view of the project.[189] These action items, however, may not have an immediate impact on the international tax regime and tax treaties. By design, these action items have mostly been charged with producing reports, not action plans (no pun intended). One may interpret this as a signal of the OECD's disbelief or lack of interest in comprehensive reform. Yet, it is not unreasonable to

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187. Note that this is a desirable development since, if successful (and that is not certain since all countries observe the actions of the OECD), it would eventually provide a chance for a new coordination-based rather than competition-based regime to be established.

188. I.e., the combat of BEPS by the largest MNEs.

189. For example, action items 1, 3, 4, 5, 6, 14, and 15. ACTION 1 FINAL REPORT, *supra* note 41; ACTION 3 FINAL REPORT, *supra* note 44; ACTION 4 FINAL REPORT, *supra* note 106; ACTION 5 FINAL REPORT, *supra* note 108; ACTION 6 FINAL REPORT, *supra* note 114; ACTION 14 FINAL REPORT, *supra* note 31; ACTION 15 FINAL REPORT, *supra* note 83.

acknowledge that the short timeframe of BEPS could not accommodate serious reform of this magnitude. This article supports this latter interpretation and argues that the most significant contribution of the BEPS project to the international tax regime will not be in the implementation of the immediate recommendations but rather in the steps made toward comprehensive reform. This section substantiates this argument, beginning first with its most typical and important example: BEPS action item 15.

1. The Multilateral Instrument

The first dramatic achievement of BEPS is its conclusion that a multilateral tax treaty instrument is not only desirable but also both legally possible and practically feasible.[190] Action item 15 had a limited goal: to explore whether such a conclusion could be made. Yet, the OECD has gone further, using the power of inertia to proceed toward the establishment of the instrument in the post-BEPS era.

The drama here is not so much the actual progress, itself an unmistakable achievement, but the dismissal of the most common opposing arguments against multilateral tax arrangement: that they are legally impossible to construct and clearly impossible to implement. The argument about the limited scope of the instrument according to the current BEPS project (i.e., the amendment of multiple tax treaties to conform to some BEPS norms) is unimportant. It would be senseless to believe that such an instrument would be abandoned after the countries commit to an instrument that implements the few BEPS treaty norms that gained consensus. A multilateral instrument will clearly be supportive of an international tax forum, even if it is not a condition for the establishment of such forum. This instrument would give power for such a forum and would incentivize countries to participate in it.

It is crucial to understand that a multilateral instrument does not present a death sentence for bilateral tax treaties and the current regime. One may reasonably claim that it would save them. Much duplication and waste would be avoided if treaty negotiation were streamlined. A proper understanding of tax

190. *See* ACTION 15 FINAL REPORT, *supra* note 83.

treaties, not as essential norm makers but rather as comity enhancing tools, should make treaties more rather than less effective.

Finally, a multilateral instrument does not have to develop into a multilateral tax treaty, at least not of the kind typically criticized by conservative observers. The all-or-nothing approach dominated the international tax discourse, dictating a binary choice between a single all-encompassing supranational multilateral tax treaty that is supposedly promoted by (complete) harmonization proponents and the current regime that is based on a large number of bilateral tax treaties. Breaking away from this approach would permit countries to make progress—including effective multilateral reforms—without giving up the whole store. Countries would be able to keep negotiating and would hold some unique positions in bilateral or other settings, yet they would not be required to waste efforts and capital over unnecessary, non-policy-related matters. These are luxury expenses that most countries, including the richest, presently cannot afford.

2. Standard Transfer Pricing and CbC Reporting

The second dramatic achievement of BEPS is the standard transfer-pricing reporting, particularly the CbC reporting framework. In a striking similarity to the rhetoric on the multilateral instrument previously discussed, the OECD is attempting to ameliorate the impact of this development. CbC reporting has been dramatically decimated to a framework and includes very little reporting that is new, relevant, or useful for BEPS to counter sophisticated tax authorities. Now, however, such information is also available to less sophisticated and less funded authorities. It is also part of the official correspondence of MNEs.

This reporting is useful not only for benevolent tax authorities that simply could not afford economically or politically to obtain the needed information to enforce their tax laws but also in cases where transparency was lacking for other reasons. Now, it would be difficult for tax authorities to ignore the disturbing numbers,[191] the exposure of which triggered the BEPS project. One should not forget that tax authorities did not start the project or initiate the complaints preceding it. In fact, the project was forced and compelled by politicians. The tax authorities have

191. *See supra* note 6.

long ignored this data, a task that would be very difficult when it is clearly and uniformly presented to them and too many other authorities at the same time.[192]

Even more obvious is the impact on the taxpayers themselves. MNEs would have to operate much more carefully when such work papers become mandatory. Collusion between taxpayers and tax authorities would also be more difficult when the reports are available to multiple tax authorities. A more realistic view of these reports reveals a much larger potential impact of these reports. First, once disseminated, these reports are potentially exposable, especially with multiple tax authorities involved. Media, disgruntled whistle-blowers, and litigation come to mind first in this regard. This makes the stakes much higher for both tax authorities and taxpayers, and the chance of real success is significantly more meaningful.

Beyond the information itself, these reports may be influential in another way. The OECD has strongly emphasized that the CbC reports in particular may only be used by tax authorities (being confidential, not publicly available) and only for the purposes of risk assessment in the process of transfer-pricing enforcement. This emphasis hides a concern that tax authorities would apply formulary mechanisms to challenge taxpayers and deviate from the arm's length standard. The temptation to take this route would be that the information is organized and available in a manner that makes formulary taxation easy and almost direct. This is interesting at a time where the OECD has promised to question its devotion to the arm's length standard and deviate from it when it does not work. Regardless of the normative aspects of the issue, it is clear that the OECD here is either naïve or not genuine. It is not reasonable to request such restraint from small, poor tax authorities when they may view it as the only path they can take to collecting revenue from MNEs.

What is the tax-treaty angle here? Most obviously, the implementation of the arm's length standard is presented as part of tax treaty law, despite the lack of an obvious obligation to that effect in actual tax treaties. The reporting and the standardization would clearly assist the varying transfer-pricing charge of treaties. Yet, more importantly, the multilateral setting of the

192. *See, e.g.*, *Caterpillar's Offshore Tax Strategy: Hearing Before the Subcomm. on Investigations of the S. Comm. on Homeland Sec. & Gov't Affairs*, 113th Cong. (2014).

reports will necessarily enhance coordination of transfer-pricing norms and would make it cheaper and seamless in implementation. A key component here could be the requirement to report a single set of transfer prices in multiple jurisdictions, which, if at all, is presently very weak. Tax treaties would be a natural place to clarify and implement such a norm.[193] Note that these advantages would arise in both a bilateral and a multilateral tax treaty setting.

3. Dispute Resolution: Is it Left Behind?

The unfinished nature of the progress made in BEPS toward institutionalization and further centralization of the international tax regime is particularly apparent in the project's progress on dispute resolution. Dispute resolution is very important to complete a minimal infrastructure for the regime. Once a multilateral instrument is implemented, the regime would have a norm-making procedure as well as imperfect implementation and reporting powers. The current regime's dispute resolution mechanism, however, is lacking and without a robust operation for resolving disputes. Thus, it is doubtful that the next step toward institutionalization can be made.

Interestingly, the issue here is not the content, as it seems that there is little opposition to mandatory "baseball" arbitration as a desired solution (even if alternative mechanisms may be able to supplement it). The OECD supported this solution even before BEPS and continues to promote it through action item 14 of the BEPS action plan. Yet, little progress was made on this matter. As already mentioned, the pact of a significant group of powerful countries to commit to mandatory arbitration in all of their tax treaties is encouraging, yet it is difficult to assess whether eventually it would be meaningful and successful.

It is not difficult to observe that the problem here is the distrust among the new partners in the project. Outsourcing adjudication may expose some countries' concessions of tax sovereignty, making it politically not feasible to support it even in the context of BEPS, and especially when OECD is promoting the

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193. Indeed, the use of tax treaties, or more specifically the exchange of information mechanisms in tax treaties, could be the next battleground in the implementation of these transfer-pricing reporting requirements. The United States has already expressed its anxiety over the matter. *See* Alex M. Parker, *Stack: U.S. Would Halt Exchange of Tax Data If Made Public*, 24 TAX MGMT. TRANSFER PRICING REP. 1291 (2016).

solution. Such lack of progress is likely to hamper serious progress toward institutionalization of the international tax regime. Technically, it is possible to keep the current noncommittal regime, but that would limit its efficacy. Perhaps a better solution would be to exploit the flexibility of the current regime and step outside of it for the purposes of dispute resolution. Outside organizations dominate similar dispute resolution regimes and are quite effective For example, the European Arbitration Convention is a separate treaty (and entity) from the European Union,[194] and the International Centre for Settlement of Investment Disputes ("ICSID") is the most common institution used in arbitration pursuant to the international investment regime.[195] There is no reason why trust issues could not be overcome by the use of different institutions. Tax treaties can clearly accommodate such a solution and is evidenced by the treaties that actually adopted mandatory arbitration. Such a development should not affect the future of tax treaties beyond the risk of nonaction on the stability of the whole international tax regime.

C. Principles in a Fog

Some other fundamental norms have taken less clear paths. Unfortunately, the substantive rules of tax treaties have been much less successful than their structural aspects. BEPS dealt with three basic issues related to the substantive rules of the international tax regime, all of which are strongly embedded in tax treaties. First, "more" source taxation was required to appease developing countries. Second, some circumstances were not effectively regulated, either because of deficient rules or economic development not anticipated by the current rules, and therefore required changes in the norms. Third, unacceptable, so-called stateless income avoided taxation, which required

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194. *See* Convention on the Elimination of Double Taxation in Connection with the Adjustment of Profits of Associated Enterprises, Aug. 20, 1990, 1990 O.J. (L 225) 10 (EC); *see also* Dirk Schelpe, *The Arbitration Convention: Its Origin, Its Opportunities and Its Weaknesses*, 4 EC TAX REV. 68, 70–71 (1995); Luc Hinnekens, *European Arbitration Convention: Thoughts on Its Principles, Procedures and First Experience*, 19 EC TAX REV. 109 (2010).

195. *See* Sergio Puig, *Emergence & Dynamism in International Organizations: ICSID, Investor-State Arbitration & International Investment Law*, 44 GEO. J. INT'L L. 531, 540 (2012) (discussing the dominance of ICSID in international investment law and its challenges).

changes in the norm in order to subject it to tax jurisdiction. Unfortunately, BEPS primarily focuses on the last issue, effectively abandoning the first two. Ultimately, the unclear principles underlying the international tax regime and the reluctance of countries to engage in a meaningful discourse over such principles are at fault. Until such a discussion takes place, reform has no chance of success.

1. The Single Tax Principle

The appealing single tax principle naturally makes double non-taxation a corollary to double taxation, the longstanding core purpose of tax treaties. Yet, presenting these two issues as mirror images of each other is wrong and harmful, both normatively and practically. The most obvious practical example is the BEPS work on action item 2, which recommends that certain countries tax income that they do not wish to tax under their domestic laws just so that such income does not go untaxed.[196] There is no principle-based reason, except for perceived administrative convenience, to choose these and not other countries. This solution is very different from the supposedly mirror situation where both jurisdictions wish to tax a single item of income and one or both concede part or all of their claims.

The single tax principle ignores the key issue of tax base division that is at the core of the BEPS project. The BEPS solutions do not support a claim by source countries to tax, and sometimes they do not support their claim not to tax. This is unlikely to improve the legitimacy of the BEPS project and (by that) its chances of success. Finally, tax treaties are not really designed to combat against double non-taxation, except through purposive interpretation. The attempt to infuse norms of this kind into treaties is questionable and would interfere with proper interpretation.

2. Source and Residence

Rivers of ink have been poured over the dichotomy between residence and source taxation and its dominance of the international tax discourse. This article does not join this discourse, but

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196. These could be countries that use exemption as a method to relieve double taxation or countries that grant tax incentives to attract foreign investment. In any event, the point is that they made policy decisions that they should not tax in these circumstances. *See supra* note 60.

rather raises a question about the utility of this dichotomy and points to the harm that stubborn insistence of organizing the whole regime around these concepts may cause.

Take, for example, action item 2. The conflict there is typically between a residence and source country, although conflicts between two potential residence countries or source countries also arise.[197] Third-party countries may also be affected. The point is that two countries independently have legitimate tax jurisdiction as either residence or source countries, yet they apply rules, legitimate in and of themselves, that fail to result in acceptable "single" taxation (double non-taxation). The residence/source rules of the international tax regime were designed to deal primarily with double taxation and its elimination. Hence, their primary effect is to limit source taxation and then, secondarily, to relieve double taxation by requiring the residence country to respect whatever source taxation left is duly collected. Despite its success over the years, this mechanism has been imperfect, and much double taxation was left unresolved by it. The OECD has attempted to improve this by applying unifying standards for some conflict of qualifications[198] and in the partnerships area,[199] for example, yet these attempts are only somewhat successful, partly because they are left as guidance external to the core international tax regime and because they have not enjoyed a meaningful consensus. Sometimes classifications of residence or source does not simply mean what it does in the straightforward, simple cases.[200] This is the case with hybrid mismatches. The rules simply do not fit them. Therefore, it should not have been surprising that the standards applied by the OECD to resolve conflicts, based on principles developed in the course of the attempt to resolve double taxation, do not fit either. Double non-taxation was not originally perceived as a problem of the international tax regime. The creators of the regime who were concerned with overtaxation wanted to ensure free trade and limit

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197. *Id.*

198. OECD COMMENTARIES, *supra* note 55, art. 1, para. 23.

199. *See* OECD, *supra* note 97.

200. This occurs in many different ways, for example: when the universal source rule refers to residence, such as in the case of dividends or capital gains; or when the source is arbitrary, such as in many cases of digital products; or in the various complex circumstances known as triangular cases. *See* FETT, *supra* note 56.

the powers of overextending government in order to protect investors and entrepreneurs. Exchange of information was considered sufficient to protect the tax base of countries. The current rules, therefore, are unsurprisingly incapable of dealing with powerful taxpayers who erode such tax bases. Nonetheless, the OECD and countries in general have acknowledged the problem of double non-taxation as a mirror problem of double taxation, and as such have applied supposedly "mirror" rules.

Nevertheless, the source and residence rules have problems beyond the interaction with the single tax principle. Sometimes they are difficult to apply to novel circumstances. The obvious example is the digital economy. It would be ridiculous to source income generated by that economy and even harder to enforce rules based on such sourcing.

Similarly, the residence concept does not fare much better, although its main problem is not new. BEPS is about corporations and the corporate tax, and corporations do not "reside" anywhere. Countries assign corporate residence based on various unconvincing constructs. Yet, eventually, assuming we accept the corporate fiction or metaphor for tax purposes, the corporate residence rules are merely technical in the service of general tax policies.[201] Even now at the end of the BEPS project, the OECD cannot disconnect from the need to have a standard rule for corporate residence (it did get rid of the completely unworkable rule it previously used).

3. And, of Course: Arm's Length

Whatever façade the OECD wishes to maintain, its transfer-pricing norms are not working. The problem is not just in the implementation or the moral character of practitioners as the OECD seems to argue. The problem is that the arm's length standard is clearly unworkable, particularly for intangibles or any other difficult cases (yet, awkwardly, this standard has been elevated to a level of "principle," as all OECD communications now use this new semantic that is very ironic in such an unprincipled project[202]). The OECD already acknowledged it, yet could

201. *See*, *e.g.*, Marian, *supra* note 94.

202. For more on this unfortunate action, see Yariv Brauner, *Changes? BEPS, Transfer Pricing for Intangibles, and CCAs*, *in* TRANSFER PRICING IN BEPS (forthcoming 2016).

not make the leap forward to reform the rules based on its original observation that in some cases "going beyond arm's length" is inevitable. The resort to profit splits is not sufficient since the OECD and governments have insisted for the longest time now that profit split is arm's length compatible[203] and, therefore, have constrained the method, inflicting it with many of the defects of the other rules.

Infusing the rules with formulary elements is inevitable indeed and will happen regardless of the opposition or the verbal dress up of the rules. Interestingly, the adoption of CbC reporting would, perhaps unintentionally, assist in this process, despite the opposition of the OECD and other conservatives. Poorer countries are unlikely simply to ignore the potential in the report for efficient enforcement while they struggle with costly and convoluted arm's length enforcement. An honest reform would have been much more desirable, efficient, effective, and just. Ultimately, these are just a few of the most salient examples of the hurdles that the OECD created by its insistence to avoid a principled approach to international tax reform and to stick to traditional concepts without much thought about the implications of such a decision.

D. Can Current Bilateral Tax Treaties Survive Post-BEPS?

If one affirmative conclusion can be made here, it is that tax treaties would survive post-BEPS and, perhaps, would even continue to thrive (likely with few changes in the short-term). The most significant risk that tax treaties face is the dismantling of the international tax regime. In practice that would occur if countries decide to abandon tax treaties, likely in favor of unilateral, defensive measures,[204] and, perhaps, some looser, minimal arrangements in regions or in political groups.

This, of course, would be in direct contrast to the purpose of the BEPS project that seeks more rather than less coordination and even designates such enhanced coordination as necessary for all of the countries involved in the project. Yet, the immediate

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203. *See* François Vincent*, Transfer Pricing and Attribution of Income to Permanent Establishments: The Case for Systematic Global Profit Splits (Just Don't Say Formulary Apportionment)*, 53 CAN. TAX J. 409 (2005).

204. This article assumes that the choice of a comprehensive multilateral, supranational treaty of the WTO sort presently is off the table.

impact of BEPS, particularly its practical implementations (reflecting the minimal view of the project), has been the exact opposite. Perversely, many countries chose to preempt BEPS and unilaterally adopt BEPS-fighting mechanisms through legislation, regulation, or even just administrative changes of course.[205] This is particularly disturbing since perceived leaders of the project took some of the most egregious actions. Notably, when the United Kingdom enacted a "diverted profits tax" and patent box regime, the former only vaguely resembled BEPS action, and the latter was enacted during efforts to combat patent box regimes.[206]

Yet, this should not be too surprising since the OECD's work on the practical aspects of BEPS was dominated by the idea of seeking best practices that would be unilaterally implemented into law by the various countries involved. At first impression, this should not surprise since best practices are the ultimate soft-law mechanism for normative change. Standardization of the international tax regime is the ultimate goal of the OECD, and best practices is the quickest mechanism to affect change. It is more difficult to seek consensus over model treaty amendments and, even then, it can take a long time until actual treaties implement them. Moreover, the focus of the minimal view of BEPS is that antiabuse and anti-abuse norms are primarily domestic by tradition and through decisions by the OECD, even when treaties apply. An additional advantage is that best practices could be presented as deliverables in a short timeframe, making BEPS a potentially successful project, even if none of the rules actually carry legal significance at the time success is declared.

As already explained, the normative basis for most of the BEPS actions is very questionable. At the end of the day, BEPS delivered a potpourri of anti-abuse rules with essentially no standards or principles to guide their interpretation and reasonable implementation. If success means vast implementation by countries of the various proposed best practices, then BEPS

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205. *See* Amanda Athanasiou, *Jumping the Gate on BEPS Unilateral Actions*, 77 TAX NOTES INT'L 937 (2015); Stuart Gibson, *Jumping the Gun on BEPS—Is the United States Next?*, 78 TAX NOTES INT'L 689 (2015).

206. *See* Mindy Herzfeld, *The U.K. Embraces Tax Competition and BEPS*, 75 TAX NOTES INT'L 85 (2014).

would necessarily fail to achieve its original promise and purpose: to enhance coordination in the acknowledgment that unilateral action is bound to fail in our interdependent world.

The reality may be even worse. Countries have, as already said, adopted additional domestic rules in an uncoordinated manner, even before knowing what the OECD recommendations would be.[207] Such action directly increases mismatches in laws, it incentivizes retaliation or even less tactical behavior that is unlikely to follow the strategy eventually provided for by the OECD, and penalizes the countries that have been most cooperative with the OECD by waiting patiently for its recommendations. MNEs are also clear losers here, at least in the short-term. They face less rather than more clarity. Eventually, there may be more tax-planning opportunities when the fog disappears, yet, currently, the costs of uncertainty are quite significant. Perhaps the most worrying trend is the tightening of enforcement in many countries. Again, this may seem desirable and consistent with BEPS, yet often it is done in an unorganized and legally questionable manner, and it clearly changes traditions that may be harmful in the long run. Note that much of these costs are likely to go to waste and not to the coffers of governments.

Presently, the magnitude of rogue action does not seem to be significant enough to collapse the regime. Yet, retaliation and short-term strategies of countries are likely to weaken rather than strengthen the regime. A shift of focus to antiabuse is necessarily a shift of focus away from coordination and, subsequently, from tax treaties to unilateral domestic measures. Lack of certainty and weakening of the rule of law, even if just in the form of reduced standardization as effected by tax treaties, would obviously diminish the impact of tax treaties and treaty law on international trade. It may spiral to a complete collapse of the regime. If this momentum continues post-BEPS, rather than enhanced coordination and institutionalization, the chance of survival for the international tax regime and tax treaties will not be promising.

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207. *See*, *e.g.*, *supra* text accompanying note 200; *see also* Mindy Herzfeld, *A Looming Global Tax War?*, 81 TAX NOTES INT'L 467 (2016).

CONCLUSION

Tax treaties shall survive BEPS. This article argues that, at best, the project will likely result in minimal reform of the international tax regime and its institutions. No one should be happy with this outcome, except perhaps a few OECD officials, as the world is now less certain with respect to cross-border investment, the rule of law becomes less robust, and the fundamental problem of fair division of tax bases remains unresolved. Yet, the article points to a silver lining in the dynamics of the BEPS project, specifically in the implementation phase. The multilateral instrument talks—even if not successfully concluded in the short-term—have effectively disposed of the notion that tax coordination on a global basis is not technically feasible. The progress on dispute resolution, emphasizing mandatory arbitration, has proven again that the challenges are not technical but rather a matter of trust building. And the standardization of transfer-pricing reporting, likely the most meaningful of all actual reforms, provides a roadmap for coordinated and standard tax rules for the benefit of all. Together, these developments demonstrate that enhanced coordination, already acknowledged by most as the sole path for progress on international tax matters, is possible and beneficial, even if disliked by a few powerful interest groups. Resistance does not stir reform in a different direction but rather simply defers progress, often with grave consequences to most stakeholders.

The article explains the importance of institutional reform and its impact on the success of coordination-centered reform. It further notes that a rushed, political program that is not based on relatively clear and agreed upon principles cannot succeed, as clearly demonstrated by BEPS. Ironically, if BEPS followed the rhetoric it used in its initial stages (coordination, holistic reform, and innovation), it would have a much better chance of success. Therefore, future decision makers do not need to "reinvent the wheel" and will do well to study the BEPS project, its promise, and its shortcomings in the next "round" that is likely to take place soon, as the fundamental challenges are too important for all and have not gone away.