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Gadžo, Stjepan; Jozipović, Šime

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Stjepan Gadžo* & Šime Jozipović**

Among the other rationales underlying the existence of corporate income tax (CIT) as a standalone tax on the profits derived by legal entities, some scholars have underlined its regulatory function, i.e. its potential to steer the behaviour of private sector actors. In this regard, it has to be noted that significant constraints on the use of CIT as a regulatory tool have emerged in the aftermath of the base erosion and profit shifting (BEPS) project. One example may be found in the new 'modified nexus approach' with regard to tax incentives for R&D activities. This article takes a regulatory perspective regarding the recent attempts to overhaul the 'international corporate tax regime', resulting in the adoption of new hard- and soft-law rules. The regulatory perspective is understood here as the capacity of the rules of international tax law to affect the behaviour of both corporate taxpayers in arranging their cross-border activities and the States in designing their CIT systems. The BEPS initiative, being an unprecedented exercise in tax coordination aimed at widespread avoidance practices, serves as a prime example of how international tax law fulfils its regulatory function, by guiding the behaviour of both governments and taxpayers. Accordingly, the paper argues that the international corporate tax regime post-BEPS exhibits two sides of the same regulatory coin: on the one hand, taxpayers are disincentivized to resort to particular types of international tax planning; on the other, the incentives for individual States to engage in corporate tax competition are significantly reduced. It is further argued that the most far-reaching proposal in this area relates to 'global minimum tax', drawn under Pillar Two of the 'BEPS 2.0' initiative.

Keywords: international tax law, tax competition, regulatory taxation, tax incentives, tax avoidance, BEPS, global minimum tax.

1 Introduction

Over the last decade, principles and rules of international tax law, previously confined to technical or academic debate, have gained unprecedented traction in the public domain.[1] The determination of governing elites in a vast number of countries to change international tax rules for the purpose of addressing widespread tax avoidance practices of large multinational corporations (MNCs) is epitomized by the OECD/G20 initiative on 'base erosion and profit shifting' (BEPS).[2] Upon its unveiling with the 2013 report[3] and the development of a comprehensive 'action plan',[4] the BEPS initiative yielded significant outputs in the form of 'final reports' on individual action items in 2015,[5] as well as the signing of the multilateral convention amending tax treaty rules (the 'Multilateral Instrument', or the MLI) in 2017.[6] An analysis of the international tax system 'post-BEPS'[7] has been further complicated by measures adopted unilaterally in some jurisdictions, departing, to a greater or lesser extent, from the 'consensus-based approach' promoted by the OECD. Perhaps most notably, the US – being concomitantly the largest economy in the world and a staunch critic of a number of measures proposed in the final BEPS package – introduced important changes to its approach

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* Assistant Professor at University of Rijeka, Faculty of Law. Email: sgadzo@pravri.hr.

** Assistant Professor at University of Split, Faculty of Economics, Business and Tourism. Email: sjozipov@efst.hr.

1 On the following that international tax has received in the public recently *see* e.g. Y. Brauner, *What the BEPS?*, 16(2) Florida Tax Rev. 56–58 (2014); M. S. Corwin, *Sense and Sensibility: The Policy and Politics of BEPS*, Tax Notes 134–135 (6 Oct. 2014).

2 For a general overview of the BEPS project *see* e.g. C. Schelling, J. Salom & N. Burkhalter, *Overview of the Base Erosion and Profit Shifting Project,* in *Base Erosion and Profit Shifting (BEPS): Impact for European and International Tax Policy* 1–19 (R. Danon ed., Schulthess 2016).

3 OECD, *Addressing Base Erosion and Profit Shifting* (OECD Publishing 2013).

4 *Ibid.*

5 The OECD final reports on fifteen BEPS action items are available online at http://www.oecd.org/ctp/beps-2015-final-reports.htm (accessed 27 Jan. 2020).

6 OECD, *Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting* (OECD Publishing, Nov. 2016).

7 For a view that the BEPS initiative indeed denotes a new stage in the development of international tax law *see* J. M. de Melo Rigoni, *The International Tax Regime in the Twenty-First Century: The Emergence of a Third Stage*, 45(3) Intertax 205–218 (2017).

in taxing cross-border transactions in late 2017, within the comprehensive tax reform pushed by the current Republican-led administration.[8]

These developments undoubtedly have a profound impact on national corporate income tax (CIT) systems, raising a variety of issues for policymakers around the globe. For example, it seems that new international standards – most importantly, those envisaged in the BEPS documentation – put significant constraints on the use of CIT as a regulatory tool, i.e. for the purpose of steering the behaviour of private sector actors.[9] Governments often tweak some elements of domestic CIT laws at least implicitly for a regulatory purpose, e.g. by providing tax incentives for R&D activities.[10] As substantiated in the abundant literature on tax competition, and as underscored within the BEPS project, such practices may have undesirable effects in a cross-border setting, inducing MNCs to use complex tax planning techniques to minimize their global tax burden. Put simply, tax competition – with CIT rules at the heart of it – gives enterprises the opportunity to effectively shop throughout the world for the most favourable tax climate.[11] Accordingly, a variety of new rules have been developed at the international level with the aim either: (1) to limit the legislative freedom of States in the area of corporate taxation, e.g. the rules implementing the 'modified nexus approach' with regard to R&D incentives; or (2) to offset the benefits that flow to MNCs from the disparities between domestic CIT laws. The rules falling in the former category are quite diverse, including, for example, the rules targeting hybrid arrangements, rules on interest deductions, controlled foreign companies (CFC) legislation, etc. Even more interestingly, as part of the 'BEPS 2.0 initiative', instigated in early 2019, the OECD called for the introduction of a 'global minimum tax', i.e. a set of rules ensuring that enterprises engaged in cross-border economic activities pay a certain minimum level of tax, thus effectively setting a floor for tax competition.[12]

These and other newly adopted or proposed instruments – e.g. in the area of taxation of the digital economy – raise important questions on the future of the 'international tax regime'. Accordingly, this article wishes to explore the recent attempts to overhaul the international tax regime from the regulatory perspective. The regulatory perspective is understood here as the potential of domestic, supranational and treaty rules to affect the behaviour of both corporate taxpayers in arranging their cross-border activities and the States in designing elements of their CIT systems. In this regard, the paper argues that the international corporate tax regime post-BEPS exhibits two sides of the same regulatory coin: on the one hand, taxpayers are disincentivized to resort to particular types of international tax planning; on the other, the incentives for individual States to engage in competitive legislative activities in the area of CIT are significantly reduced. While taken at face value it seems that these developments limit the discretionary space of States' tax sovereignty, they may actually lead to a completely opposite outcome: the revitalization of States' power to tax corporate income at the effective rates they see fit, due to reduced competitive pressures induced by the behaviour of other actors in the international arena.

The rest of the paper unfolds as follows. Section 2 starts with a general description of the regulatory function of CIT. It continues by describing the reality of the competitive-based international tax regime, where States compete for mobile tax bases such as capital income. It further argues that, against the backdrop of international tax competition and tax avoidance, the regulatory function of internationally developed anti-competitive and anti-avoidance standards may be discerned and articulated. Section 3 examines the constraints on corporate tax competition envisaged within the BEPS project, which have been translated into hard- or soft-law instruments. Section 4 is devoted to recent developments regarding global minimum tax which signify an important change in the paradigm of tax competition for real economic activities. Concluding remarks are presented in section 5.

2 The Regulatory Function of CIT and Its Interrelationship with International Tax Competition and Tax Avoidance

The primary purpose of any tax system is the acquisition of funds for public purposes.[13] However, it has long been clear that the effects of taxation reach beyond such purely

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8 For an overview of the 2017 US tax reform *see* e.g. M. M. Levey et al., *Taking Stock of US 'Tax Reform' as the Dust Settles*, 46(4) Intertax 352–355 (2018).

9 Generally on this function of the CIT as a standalone tax on the profits derived in corporate form, *see* e.g. M. E. Komhauser, *Corporate Regulation and the Origins of the Corporate Income Tax*, 66(2) Indiana L.J. 53–136 (1990); R. S. Avi-Yonah, *Corporations, Society, and the State: A Defense of the Corporate Tax*, 90(5) Va. L. Rev. 1193–1255 (2004). For a more detailed discussion *see infra*, s. 2.

10 *See* e.g. L. G. Ogazón Juárez & D. Calderón Manrique, *Introduction to Tax Incentives in the BEPS Era*, in: *Tax Incentives in the BEPS Era*, IBFD Tax Research Series, vol. 3 (M. Cotrut et al. eds, IBFD 2018); OECD, *Corporate Tax Statistics* (OECD Publishing 2018), https://www.oecd.org/tax/tax-policy/corporate-tax-statistics-database-first-edition.pdf (accessed 27 Jan. 2020). For a more detailed discussion *see infra*, s. 2.1.

11 *See* T. Dagan, *International Tax Policy: Between Competition and Cooperation* 23–30 (Cambridge University Press 2018).

12 *See* OECD, *Programme of Work to Develop a Consensus Solution to the Tax Challenges Arising from the Digitalisation of the Economy,* OECD/G20 Inclusive Framework on BEPS (OECD Publishing 2019), https://www.oecd.org/tax/beps/programme-of-work-to-develop-a-consensus-solution-to-the-tax-challenges-arising-from-the-digitalisation-of-the-economy.pdf (accessed 27 Jan. 2020).

13 D. Birk, *Steuerrecht* 61 (C.F. Müller GmbH 2011).

fiscal or revenue terms. As argued by Avi Yonah, apart from the revenue-raising goal, taxation in a modern state has another well-known purpose – the redistribution of income.[14] Furthermore, a third general purpose of taxes can be identified: the regulatory purpose.[15] The latter entails the use of the tax system, or rather some of its numerous elements, with the aim of affecting the behaviour of citizens, corporations, and other private sector actors, either by incentivizing certain types of activities or by disincetivizing – or rather penalizing – some other activities.[16]

2.1 *Generally on the Regulatory Function of CIT*

In some jurisdictions, this dual character is clearly imbedded in constitutional and legislative practice. For instance, in German tax law, it is clearly within the prerogative of the legislator to introduce regulatory taxes, as long as they also have a fiscal dimension to them.[17] Accordingly, only those taxes that do not fulfil any fiscal purpose but have just a penalizing character (the so-called *Erdrosselungssteuern*) will fall short of this requirement under German law.[18] While it is hard to draw a clear line between regulatory and fiscal taxes,[19] the first category will usually include taxes that are directly aimed at imposing a tax burden on harmful behaviour, such as environmental pollution[20] or the consumption of harmful substances.[21] The second category, on the other hand, is linked to fiscal taxes such as (corporate) income tax, which may also include rules that in effect adjust the tax burden in accordance with a specific regulatory goal.[22]

As a general rule, while regulatory taxes impose a novel burden on the taxpayer, regulatory elements found within existing taxes decrease the tax burden for a qualifying taxpayer. These tax incentives, being exceptions from the general regime of taxation, may take different forms. As put by Easson and Zolt, '(T)hey are those special exclusions, exemptions, or deductions that provide special credits, preferential tax rates or deferral of tax liability'.[23] From the perspective of the government, tax incentives are treated as tax expenditures, due to the foregone revenue they produce.[24]

In the area of CIT, typical tax incentives include, inter alia, tax holidays, reduced tax rates, investment allowances, special economic zones (SEZs), accelerated depreciation, etc.[25] Most commonly, they serve regulatory purposes such as the promotion of investment in specific sectors of the economy, the creation of new employment in underdeveloped areas,[26] etc.[27] For example, incentives for research and development (R&D) activities are employed by a number of countries as a tool to promote the presumed positive spillover effects of these activities on the economy as a whole.[28]

It is interesting to note that, as an exception to the general pattern described above, some regulatory elements of CIT may also impose an additional tax burden in comparison to the regular level of taxation. One example of such a regulatory CIT mechanism is the limitation of interest deductions, particularly between associated enterprises. Such a limitation was introduced in Germany (the so-called *Zinsschranke*) with both a regulatory and an anti-avoidance goal in mind.[29] The limitation of interest deduction is of a regulatory nature in that it disincentivizes certain behaviour regarding corporate financing. It decreases the desirability of debt financing and makes

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14 R. S. Avi-Yonah, *Taxation as Regulation: Carbon Tax, Health Care Tax, Bank Tax and Other Regulatory Taxes*, 1(1) Accounting, Econ., & L. 2 (2011).

15 For a detailed discussion *see* R. S. Avi-Yonah, *The Three Goals of Taxation*, 60(1) Tax L. Rev. 22–25 (2006).

16 Avi-Yonah*, supra* n. 15, at 24–25. Cf. also H. Gribnau, *The Integrity of the Tax System after BEPS: A Shared Responsibility*, 10(1) Erasmus L. Rev. 18 (2017), who also uses the term 'instrumental function' in this regard.

17 *See* DE: Art. 3, para. 1, Tax Code (*Abgabenordnung*, in the version from 1 Oct. 2002 (DE: BGBl. I S. 3866; 2003 I, at 61)), last modified by Art. 10 of the law of 11 July (DE: BGBl. I S. 1066); DE: BVerfG, 10 Dec. 1980, 2 BvF 3/77, BVerfGE 55, 274.

18 Birk, *supra* n. 13, at 62.

19 *See* T. Vogel, *Die Einflussnahme steuerlicher Lenkungsnormen auf Entscheidungen von Wirtschaftssubjekten* 14 (BoD 2015).

20 In such cases, taxation basically complements more rigid exercises of public authority. *See* e.g. on this DE: BVerfG, 2 Oct. 1973, 1 BvR 345/73, BVerfGE 36, 66.

21 *See* e.g. A. Mohr, *Die Lenkungssteuer, ein Instrument zur Induzierung sozialorientierten Verhaltens im Wohlfahrtsstaat?* 191 (Schulthess Polygraphischer Verlag 1976).

22 For a discussion on how any specific tax may serve multiple basic functions, *see* Avi-Yonah, *supra* n. 14, at 6–9.

23 A. Easson & E. Zolt, *Tax Incentives* 3 (World Bank Institute 2002). For a more detailed elaboration on the concept of tax incentives *see* Ogazón Juárez & Calderón Manrique, *supra* n. 10, s. 1.2.

24 *See* Avi-Yonah, *supra* n. 15, at 23–24.

25 For an overview *see* Ogazón Juárez & Calderón Manrique, *supra* n. 10, s. 1.2; A. Klemm, *Causes, Benefits, and Risks of Business Tax Incentives*, 17(3) Int'l Tax & Pub. Fin. 317 (2010).

26 One prominent example in this regard was the preferential tax treatment for corporations in the Dublin docks area of Ireland. *See* M. Sullivan, R. Wallner & S. Wübbelsmann, *Die deutsche Hinzurechnungsbesteuerung auf dem europäischen Prüfstand*, IStR, 6, para. 30 (2003).

27 For an overview of the purposes of tax incentives *see* Ogazón Juárez & Calderón Manrique, *supra* n. 10, s. 1.3.

28 *See* Å. Hansson & C. Brokelind, *Tax Incentives, Tax Expenditures Theories in R&D: The Case of Sweden*, 6(2) World Tax J. 175–176 (2014).

29 On the regulatory purpose of this instrument *see* DE: BT-Drucks. 16/4841 (27 Mar. 2007), at 48; DE: BT-Drucks. 220/07 (30 Mar. 2007), at 53. It is interesting to draw parallel here between this instrument and the developments in the area of 'global minimum tax', analysed in *infra*, s. 4.

equity financing more attractive, with the direct consequence that the number of overleveraged corporations within a group is reduced.[30]

2.2 *The Conundrum of International Tax Competition*

One of the basic tenets of the twenty-first century global economy is the high mobility of capital across national borders.[31] Accordingly, conventional economic wisdom suggests that States – particularly small open economies – should try to reduce the cost of capital, including the CIT burden, in order to attract inbound investment, or at least prevent the relocation of capital to other jurisdictions offering more favourable after-tax returns.[32] A number of empirical studies seem to confirm that corporate taxpayers, especially large MNCs, are highly responsive to the differentials in the effective CIT burden between countries.[33] Faced with such economic reality, particularly since the 1980s,[34] a number of governments have either reduced nominal tax rates on corporate income or changed other CIT elements – including, for example, introducing new tax incentives – in order to bring the effective tax rate (ETR) to a level competitive with other jurisdictions. Accordingly, and in an analogy to the competition between actors in the private market,[35] one of the key underpinnings of the international tax regime of today is the competition between countries for any given mobile tax base, such as capital income.[36] As tellingly stated by Brauner: '(…) despite the impressive convergence of norms and standardization manifested in the international tax regime, it is a competitive, beggar-thy-neighbor approach that has been guiding the norms themselves'.[37] Indeed, it has now become commonplace in tax literature to depict each country's international tax policy choices as part of a global strategic game.[38]

Tax competition in the CIT area comes in many forms, including low general tax rates, tax incentives (see the discussion above in section 2.1), favourable tax ruling schemes, etc.[39] Therefore, the widespread use of tax incentives in domestic corporate tax laws – directly affecting the ETR – is only one of the tools of competition. Further, and more convolutedly, competitive measures may also relate to the international aspects of a domestic CIT framework, e.g. the rules defining corporate residence, rules on double taxation relief, etc., which may produce ample opportunities for tax arbitrage.[40]

It is further vital to note how, from a public international law point of view, tax competition relates to the notion of State sovereignty.[41] In simple terms, since every country chooses its own tax structure and makes relevant tax rules as a matter of the exercise of its sovereignty, any effort to curtail tax competition entails inter-state coordination, enshrined in an agreed legal instrument.[42] This may be either a 'hard-law' instrument – e.g. an international treaty – or a 'soft-law' instrument, such as recommendations adopted by the OECD.[43]

While a more detailed elaboration on the benefits and shortcomings of international tax competition lies outside the scope of this article,[44] it is widely understood that there are strong policy reasons for at least some degree of international cooperation with the aim of establishing limits to – or, rather, regulating – tax competition.[45] This type of collective action is essentially about setting common standards on what kind of State behaviour regarding tax incentives and other competitive instruments is considered acceptable. It is precisely here that

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30 *See* Vogel, *supra* n. 19, at 91; DE: BT-Drucks. 16/4841 (27 Mar. 2007), at 48; DE: BT-Drucks. 220/07 (30 Mar. 2007), at 53.

31 *See* the discussion in S. Gadžo, *Nexus Requirements for Taxation of Non-residents' Business Income: A Normative Evaluation in the Context of the Global Economy,* Doctoral Series vol 41, 227–231 (IBFD 2018).

32 On this argument *see* W. Schön, *International Tax Coordination for a Second-Best World (Part I)*, 1(1) World Tax J. 82–83 (2009); R. Collier & G. Maffini, *Tax Competition, Tax Co-Operation and BEPS*, 3(1) J. Tax Administration 24–26 (2017).

33 *See* e.g. J. H. Heckemeyer & M. Overesch, *Multinationals' Profit Response to Tax Differentials: Effect Size and Shifting Channels*, 50(4) Canadian J. Econ./Revue canadienne d'économique 965–994 (2017). Cf. also the literature review in S. Beer, R. A. de Mooij & L. Liu, *International Corporate Tax Avoidance: A Review of the Channels, Magnitudes, and Blind Spots*, IMF Working Paper No. 18/168 (July 2018), https://www.imf.org/en/Publications/WP/Issues/2018/07/23/International-Corporate-Tax-Avoidance-A-Review-of-the-Channels-Effect-Size-and-Blind-Spots-45999 (accessed 27 Jan. 2020).

34 *See* L. V. Faulhaber, *The Trouble with Tax Competition: From Practice to Theory*, 71(2) Tax L. Rev. 326 (2018).

35 On this *see* Faulhaber, *supra* n. 34, at 316–317. For a more detailed discussion on tax competition as a form of market competition *see* Dagan, *supra* n. 11, at 23–30.

36 *See* Schön, *supra* n. 32, at 70–71.

37 Brauner, *supra* n. 1, at 65.

38 *See* Dagan, *supra* n. 11, at 60–71. Cf. also M. Keen, *Competition, Coordination and Avoidance in International Taxation*, 72(4/5) Bull. Int'l Tax'n. 220–224 (2018).

39 For a detailed and systematic account *see* Faulhaber, *supra* n. 34, at 360–363. For a cross-country evaluation of the attractiveness of CIT systems *see* e.g. D. Bunn & E. Asen, *International Tax Competitiveness Index 2019* (2019), https://taxfoundation.org/2019-international-index/, at 6–12 (accessed 27 Jan. 2020).

40 On some examples *see* e.g. Faulhaber, *supra* n. 34, at 351; Dagan, *supra* n. 11, at 240; Gribnau, *supra* n. 16, at 18; Collier & Maffini, *supra* n. 32, at 27–29.

41 For a general discussion on the notion of state sovereignty in the context of taxation, *see* Gadžo, *supra* n. 31, at 21–27.

42 *See* Keen, *supra* n. 38, at 221.

43 More on this point see the discussion in *infra*, s. 3.1.

44 For an overview, *see* Faulhaber, *supra* n. 34, at 318–323.

45 *See* Brauner, *supra* n. 1, at 64–65.

the regulatory purpose of international tax law plainly manifests itself. For example, the OECD's first document devoted to the issue of tax competition resulted in the identification of twelve factors that may be characterized as 'harmful tax practices' employed at the domestic level.[46] Put differently, the standards adopted on the international plane to curb tax competition serve to steer States away from adopting specific tax practices in their domestic laws, thus having a regulatory purpose. This point is illustrated more clearly below (section 3.1) in discussing the criteria set within the BEPS Action 5 to delineate between tax incentives that countries may provide to taxpayers at their own discretion and incentives that constitute 'harmful' tax competition.

2.3 *Tax Avoidance, Tax Competition and the Regulatory Purpose of International Tax Law*

On the other side of the tax competition coin lies the behaviour of MNCs as mobile taxpayers that respond to the differences in CIT systems across countries.[47] While the tax competition debate and the efforts to curtail it focus on the actions of States, sight should not be lost of the actions taken by taxpayers in response to specific legislative actions. More specifically, it is important to recognize the inseparable link between tax competition and international tax avoidance. It is the lack of harmonization between national CIT elements – including the rules on rate, base, incentives, etc. – that induces MNCs to engage in international tax planning, which on occasion crosses the boundary of tax avoidance.[48] Accordingly, the introduction of competitive instruments in domestic laws broadens the scope for, or even facilitates, taxpayers' behaviour that may be deemed illegitimate. As explained by Faulhaber:

> tax avoidance today relies on tax competition since most international tax avoidance transactions are only valuable to taxpayers if the country on the other side of the transactions provides a low rate or preferential treatment. Countries are complicit in tax avoidance schemes – and taxpayers (often multinational corporations) are complicit in tax competition.[49]

Against this background, internationally developed standards or what could or should be done to curb tax avoidance are of a regulatory nature similar to the above-discussed anti-tax competition standards. While on the face of it the latter target the States, the former seek to affect the behaviour of taxpayers themselves.[50] However, anti-avoidance rules may narrow the scope for tax competition, and, in the same way, the regulation of tax competition reduces the overall leeway for (aggressive) tax planning. The BEPS initiative, as an unprecedented exercise in tax coordination aimed at widespread avoidance practices, will be analysed in more detail below (section 3) as a prime example of how international tax law fulfils its regulatory function, by guiding the behaviour of both governments and taxpayers.

3 Constraints on Corporate Tax Competition in the Aftermath of BEPS

A fundamental insight emerging from the preceding discussion is that the 'international corporate tax regime' – as established in the 1920s and consolidated in the post-WW II period principally under the dominance of the OECD – is anchored in largely unharmonized domestic laws, some of which are primarily aimed at boosting the competitiveness of the country in the global economic environment. As pointed out by some authors, in this 'competition-based regime', collective efforts to regulate the taxation of cross-border profits – primarily via bilateral international treaties – have been of severely limited scope, reflecting the divergent self-interests of individual countries, disguised under the notion of 'tax sovereignty'.[51] This has, in turn, become fertile ground for multinational companies to engage in 'aggressive' tax

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46 *See* OECD, *Harmful Tax Competition: An Emerging Global Issue* (OECD Publishing 1998), http://dx.doi.org/10.1787/9789264162945-en (accessed 27 Jan. 2020). It is beyond the remit of the present paper to present a detailed overview of the past and present efforts at the international level to curb tax competition. For a recent and heavily footnoted account *see* Faulhaber, *supra* n. 34, at 325–340.

47 *See* Gribnau, *supra* n. 16, at 18.

48 In this paper we will refrain from a deeper discussion on the terminological difficulties surrounding concepts such as 'aggressive tax planning' or 'tax avoidance', which have been hotly debated in tax scholarship. For example, *see* A. P. Dourado, *Aggressive Tax Planning in EU Law and in the Light of BEPS: The EC Recommendation on Aggressive Tax Planning and BEPS Actions 2 and 6*, 43(1) Intertax 42–57 (2015); J. M. Calderón Carrero & A. Quintas Seara, *The Concept of 'Aggressive Tax Planning' Launched by the OECD and the EU Commission in the BEPS Era: Redefining the Border Between Legitimate and Illegitimate Tax Planning*, 44(3) Intertax 206–226 (2016); F. Cachia, *Aggressive Tax Planning: An Analysis from an EU Perspective*, 26(5) EC Tax Rev. 257–273 (2017).

49 Faulhaber, *supra* n. 34, at 313. Cf. also Dagan, *supra* n. 11, at 3; Keen, *supra* n. 38, at 222; Collier & Maffini, *supra* n. 32, at 20–29. In a similar vein, Eden dismisses the standard criticism of the arm's length standard (ALS) and transfer pricing rules as misdirected: '*Abusive transfer pricing is caused by perverse incentives — set in place by governments — that encourage MNEs to manipulate transfer prices to take advantage of differences in tax rates across jurisdictions. This is not a transfer pricing problem but an international tax regime 'design'problem. It is best handled by fixing the gaps in the international tax system rules (…) To end abusive transfer pricing, the first step must be to reduce the incentives that governments have put in place to encourage and enable MNEs to engage in these income shifting activities*' (L. Eden, *The Arm's Length Standard Is Not the Problem*, 48(10) Tax Mgmt. Int'l J. 3–4 (2019)).

50 Faulhaber, *supra* n. 34, at 341.

51 *See* e.g. Brauner, *supra* n. 1, at 61–65. Cf. also the discussion in Dagan, *supra* n. 11, at 183–184. For a more detailed elaboration on how international tax norms are generated, with the emphasis on the underlying political dimension, *see* R. Azam, *Ruling the World: Generating International Tax Norms in the Era of Globalization and BEPS*, 50 (4) Suffolk U. L. Rev. 4, at 517–586 (2017).

planning, thus legally minimizing their global tax burdens. Accordingly, the issue of international tax avoidance cannot be logically isolated from the concept of tax competition.[52]

In this light, a new generation of anti-avoidance rules emerging at the international level in recent years, particularly as a consequence of the BEPS project, may actually be seen as 'anti-tax competition measures'.[53] Before this section proceeds to discuss the most relevant anti-competitive measures in more detail, it is vital to note the two facets by which they exhibit a regulatory function, as defined in section 2. First, the BEPS initiative ushered in a new wave of standard-setting at the international level, which has had a strong impact on the discretionary decision-making powers of national governments in the domain of CIT. By virtue of both hard- and soft-law instruments, the norm-making activity of individual States has to be adjusted to new international or supranational minimum standards, thus limiting the leeway for using CIT as a tool of tax competition. Second, new international tax standards act as signposts for taxpayers engaged in cross-border activities (primarily MNCs), in that one of their paramount goals is to steer MNCs away from specific tax planning practices deemed as illegitimate tax avoidance.

3.1 *Limitations to Tax Competition Under BEPS Action 5*

One item of the BEPS Action Plan that quite explicitly addresses harmful tax competition, signifying a continuation of the OECD's earlier efforts in this area,[54] is BEPS Action 5, labelled '*Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance*'.[55] At the substantive level, the priority of BEPS Action 5 is to delineate between tax incentives that countries provide to taxpayers at their own discretion and incentives or preferential regimes that belong to the realm of 'harmful' tax competition. Accordingly, tax incentives belonging to the latter category, envisaged in domestic laws, should be abolished outright or, at the very least, amended to comply with the newly agreed criteria. In this regard, a preferential tax regime – e.g. a patent box, a holding company regime, a shipping regime, etc. – will not be considered as harmful if it satisfies certain substance requirements, namely if there is a strong economic link (a 'nexus') between the income covered by the preferential regime and the core activities undertaken by the taxpayer in order to generate this income.[56]

In addition, the work on BEPS Action 5 addressed the notorious lack of transparency as regards certain tax benefits enshrined in administrative or revenue rulings, setting out a framework for cross-border exchange of information on specific types of tax rulings.[57]

While the technical analysis of the requirements provided in the Final Report on BEPS Action 5 and the OECD's ensuing documentation lie outside the scope of the present article, it is essential to observe the effects these developments have on the legislative freedom of individual states in the area of CIT. While the substance requirements limit the capacity of a State to enter into 'unfair' or 'harmful' tax competition in the classic sense, they focus solely on one aspect of harmfulness. Conversely, the purpose and regulatory impact of the preferential regime at hand is not sufficiently considered, beyond its role as a vehicle for global tax competitiveness. This is of no surprise since any evaluation of the underlying justification of a measure runs deeply into a State's margin of appreciation in setting its tax policy.[58] Therefore, the nexus criteria envisaged under BEPS Action 5 will not curb most of the facets of tax competition. The evaluation of the effects of tax incentives thus remain mainly within the domain of individual States, potentially limited by the requirements of supranational law, e.g. primary and secondary EU law.[59]

The common standards agreed upon within this BEPS action item constitute one of the four 'BEPS minimum standards', i.e. the set of broad rules to the consistent implementation of which each of the 129 countries belonging to the BEPS Inclusive Framework committed itself.[60] The progress undertaken in this area by every

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[52] See the discussion in *supra*, s. 2.3 and the sources referred to therein.

[53] *See* Collier & Maffini, *supra* n. 32, at 29–30; Faulhaber, *supra* n. 34, at 340–342.

[54] *See supra* s. 2.2, nn. 50–51 and the accompanying text.

[55] *See* OECD, *Countering Harmful Tax Practices More Effectively, Taking into Account Transparency and Substance, Action 5 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015), http://dx.doi.org/10.1787/9789264241190-en (accessed 27 Jan. 2020).

[56] On this general principle *see* OECD, *supra* n. 55, at 37. For analysis of the OECD's 'nexus approach' in the context of preferential regimes *see* e.g. E. Traversa & A. Flamini, *Patent Boxes Before and After BEPS Action 5*, in *The Implementation of Anti-BEPS Rules in the EU: A Comprehensive Study* (P. Pistone & D. Weber eds, IBFD 2018); A. C. dos Santos, *What Is Substantial Economic Activity for Tax Purposes in the Context of the European Union and the OECD Initiatives Against Harmful Tax Competition?*, 24(3) EC Tax Rev. 166–175 (2015).

[57] *See* OECD, *supra* n. 55, at 45–60.

[58] Compare the discussion by J. Hey, *The Evaluation of Regulatory Taxes and the Legal Relevance of Their Effectiveness*, 48 Intertax (2020), in this issue.

[59] *See* A. Pirlot, *No Representation Without Effective Taxation. The Role of Tax Harmonization in Enhancing the Output Legitimacy of the European Union*, 48 Intertax (2020), in this issue.

[60] Generally on the distinction between four BEPS minimum standards and other international tax standards agreed upon within BEPS *see* OECD, *Explanatory Statement 2015 Final Reports,* OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015), https://www.oecd.org/ctp/beps-explanatory-statement-2015.pdf (accessed 27

jurisdiction is subject to ongoing monitoring and peer review procedures conducted at the OECD level.[61]

The impact of the new standards developed under BEPS Action 5 on country practices has been significant. In the three years following the adoption of the Final Report in 2015, more than 80 preferential regimes were completely abolished and another seventy-five amended to meet the new substance criteria.[62] Most eye-catchingly, virtually all of the existing intellectual property (IP) regimes put under scrutiny are considered to be nexus-compliant,[63] which in itself signifies a major change in the landscape of IP tax structuring.

For an inquiry into the regulatory aspects of *international* tax law, it is of special importance to consider the above developments from the perspective of international law and international governance. Thus, in light of the dichotomy between 'hard law' and 'soft law' traditionally used in the literature of international law,[64] it is abundantly clear that BEPS Action 5 relies on soft-law instruments to set out new standards in the area of tax competition. More precisely, relevant OECD documents do not themselves create a legal obligation upon States to act in a certain way, i.e. to amend their domestic legislation, or to abstain from introducing new harmful tax regimes. However, this is not to say that the new standards do not have any regulatory effect. Quite the contrary, the contents of BEPS Action 5 may be described as a prime example of 'mediated law' (*règle mediate*), signifying norms that are created at the international level, but which are given legal effect by further action undertaken at the level of individual States.[65] As can be seen from the above, the new standards on preferential tax regimes have been developed at the international level and enshrined in soft-law documents, subsequently implemented – either by action or inaction – by the countries belonging to the BEPS Inclusive Framework. In view of this, one may argue that the new standards have been converted or transformed into legally binding rules or 'hard law'.[66] This actually fits well with the general design of modern international tax law, where the OECD has traditionally held the role of key creator of soft-law standards that have consequently been translated into hard law by individual jurisdictions, thus driving the integration of the international tax regime.[67] Moreover, on the continuum from pure soft law to pure hard law, BEPS Action 5 – as one of four 'minimum standards' – actually includes a hard law element, in that a specific multilateral mechanism has been set up to monitor and effectuate its implementation.

To sum up, the collective efforts of BEPS Action 5 to regulate tax competition has certainly succeeded to the extent that most countries now abide by the new standards for the granting of corporate tax incentives. On the other hand, most criticism of the OECD's work in this area has been targeted at its potential to actually further intensify inter-country competition via tax rates, thus distorting choice as to the locations of 'real' investments.[68] In this regard, it has to be taken into account that, at its core, BEPS Action 5 has never been completely 'anti-incentive' or 'anti-competitive' device. Quite the contrary, the OECD has explicitly underscored that this BEPS action item is not aimed at the harmonization of national CIT systems, but rather at creating a commonly defined framework for competitive practices, e.g. vis-à-vis the requirements of substance.[69] This point is important for the ensuing discussion in the present article (section 4) on recent developments regarding 'minimum global taxation', amounting to yet another approach to the combat against tax competition.[70]

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Jan. 2020), at 6. For a more detailed analysis of the different legal mechanisms used to implement BEPS outputs *see* A. Christians, *BEPS and the New International Tax Order*, 6 Brigham Young U. L. Rev. 1639–1645 (2016).

61 For the most recent account *see* OECD, *Harmful Tax Practices – 2018 Progress Report on Preferential Regimes: Inclusive Framework on BEPS: Action 5*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2019), https://doi.org/10.1787/9789264311480-en (accessed 27 Jan. 2020).
Generally on the usage of peer review mechanism by the OECD in the international tax area *see* Christians, *supra* n. 60, at 1618–1621. For an analysis of the divergences between the peer review of preferential regimes under the BEPS Inclusive Framework and similar exercises undertaken at the EU level *see* B. Larking, *Navigating the EU-OECD Harmful Tax Competition Jungle*, Tax Notes Int'l (11 Nov. 2019).

62 *See* OECD, *OECD/G20 Inclusive Framework on BEPS: Progress Report July 2018-May 2019* (OECD Publishing 2019), https://www.oecd.org/tax/beps/inclusive-framework-on-beps-progress-report-july-2018-may-2019.htm (accessed 27 Jan. 2020), at 9–10.

63 *See* OECD, *supra* n. 62, at 9.

64 *See* e.g. M. N. Shaw, *International Law* (6th ed., Cambridge University Press 2008), at 117–119; D. Thürer, *Soft Law*, Max Planck Encyclopedia of Public International Law (Mar. 2009).

65 On the concept of 'mediated law' *see* J. Katz Cogan, *The Regulatory Turn in International Law*, 52(2) Harv. Int'l L.J. 328–329 and 349–356 (2011).

66 This is a common phenomenon with regard to the relationship between soft- and hard-law. *See* Shaw, *supra* n. 64, at 118.

67 *See* E. A. Baistrocchi, *The International Tax Regime and the BRIC World: Elements for a Theory*, 33(4) Oxford J. Legal Stud. 743–744 (2013); D. M. Ring, *Who Is Making International Tax Policy? International Organizations as Power Players in a High Stakes World*, 33(3) Fordham Int'l L.J. 652 (2010); A. Christians, *Hard Law, Soft Law, and International Taxation*, 25(2) Wisconsin Int'l L.J. 325–333 (2008); J. Chaisse & X. Ji, *'Soft Law' in International Law-Making – How Soft International Taxation Law Is Reshaping International Economic Governance*, 13(2) Asian J. WTO & Int'l Health L. & Pol'y 498–499 (2018).

68 *See* Keen, *supra* n. 38, at 224; International Monetary Fund, *Corporate Taxation in the Global Economy*, Policy Paper No. 19/007 (Mar. 2019), https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/03/08/Corporate-Taxation-in-the-Global-Economy-46650 (accessed 27 Jan. 2020), at 12.

69 OECD, *supra* n. 55, at 11–12.

70 On minimum taxation as an alternative anti-competitive measure *see* Keen, *supra* n. 38, at 224.

3.2 *The Push for a More Coherent International Tax System*

Further evidence of the regulatory function of the post-BEPS international tax regime may be found in a number of measures set up with the goal to ensure the 'coherence' of corporate income taxation. In fact, coherence has been dubbed as one of the three fundamental pillars of the whole BEPS project – alongside 'substance' and 'transparency'[71] – with the OECD being rather explicit in linking this normative ideal with the phenomenon of double non-taxation[72]:

> *BEPS issues may arise directly from the existence of loopholes, as well as gaps, frictions or mismatches in the interaction of countries' domestic tax laws (…) There is a need to complement existing standards that are designed to prevent double taxation with instruments that prevent double non-taxation in areas previously not covered by international standards and that address cases of no or low taxation associated with practices that artificially segregate taxable income from the activities that generate it.*[73]

Accordingly, the OECD made efforts to develop the new standards on hybrid mismatches (BEPS Action 2),[74] CFC rules (BEPS Action 3),[75] and interest deductions (BEPS Action 4).[76] In our view, the OECD's work on treaty abuse and treaty shopping (BEPS Action 6)[77] should also be considered as part of this category of tools targeting double non-taxation.[78] As already explained above, while this assortment of measures promoted by the OECD may prima facie be regarded as of a purely anti-tax avoidance nature, they actually have a significant impact on corporate tax competition.[79] While this point may seem self-evident and merely of a rhetorical nature, it has not always been explicitly acknowledged in the tax literature.[80] In elucidating this argument in the rest of this section, the paper refrains from analysing the technical details of individual measures, instead focusing on their overall impact on the international tax regime.

Let us accordingly first focus on the OECD's work within BEPS Action 2, which, as pointed out by several commentators, tackles some of the most basic – and most blatant – tax planning techniques giving rise to BEPS.[81] Put simply, the phenomenon of tax planning with hybrid structures/arrangements is a direct corollary of uncoordinated domestic tax legislation, where MNCs are presented with opportunities for a double non-taxation outcome through the exploitation of relevant disparities between local laws.[82] For the purpose of the present article, it is important to note that, at least in some instances, these disparities may not be easily dismissed as unintended from the perspective of individual States, but rather as yet another form of conscious, competition-driven national policy choice.[83] Accordingly, a multilaterally established set of standards aimed at neutralizing the effects of hybrid mismatches is fundamentally also about steering the behaviour of both taxpayers and governments as regards the tax classification of entities or instruments.[84] With this goal in mind, the OECD has

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71 *See* P. Saint-Amans & R. Russo, *The BEPS Package: Promise Kept*, 70(4) Bull. Int'l Tax'n (2016).

72 For a nuanced discussion on the meaning of double non-taxation *see* F. De Lillo, *In Search of Single Taxation*, in *Single Taxation?* (J. Wheeler ed., IBFD 2017).

73 OECD, *supra* n. 4, at 13.

74 OECD, *Neutralising the Effects of Hybrid Mismatch Arrangements, Action 2 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015), https://doi.org/10.1787/9789264241138-en (accessed 27 Jan. 2020).

75 OECD, *Designing Effective Controlled Foreign Company Rules, Action 3 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015), https://doi.org/10.1787/9789264241152-en (accessed 27 Jan. 2020).

76 OECD, *Limiting Base Erosion Involving Interest Deductions and Other Financial Payments, Action 4 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015), https://doi.org/10.1787/9789264241176-en (accessed 27 Jan. 2020).

77 OECD, *Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015), https://doi.org/10.1787/9789264241695-en (accessed 27 Jan. 2020).

78 Compare also C. H. J. I. Panayi, *International Tax Law Following the OECD/G20 Base Erosion and Profit Shifting Project*, 70(11) Bull. Int'l Tax'n 629 (2016).

79 *See* Faulhaber, *supra* n. 34, at 350–352; Collier & Maffin, *supra* n. 32, at 29–30.

80 As noted by Leibrecht and Rixen: 'There are two largely distinct bodies of literature and corresponding research areas in international taxation. On the one hand, there is a large and continuously growing body of theoretical and empirical literature on tax competition (…), mainly in the field of economics; on the other, there is a large body of mostly legal literature dealing with international double tax avoidance (…). The fact is, however, that there are only very few contributions that address both issues at the same time'. (M. Leibrecht & T. Rixen, *Double Tax Avoidance and Tax Competition for Mobile Capital*, in *International Tax Coordination: An Interdisciplinary Perspective on Virtues and Pitfalls* 61 (M. Zagler ed., Routledge 2010)).
As argued by Faulhaber, 'discussions of tax competition should be more explicit about the interdependence of tax avoidance and tax competition. Currently, discussions of international tax avoidance and international tax competition seesaw between enemies: Either countries are behaving badly and engaging in harmful tax competition, which is stealing revenue, jobs, and other resources from innocent other countries, 232 or multinationals are behaving badly and engaging in tax avoidance, which is stealing revenue from those same innocent countries whose rules are being interpreted aggressively. In reality, as the recent measures to combat both tax competition and tax avoidance show, all countries are engaged in tax competition to a certain degree, and the rules that they design to curtail the harmful behavior of other countries and taxpayers often contribute to this competition.' (Faulhaber, *supra* n. 34, at 363).

81 *See* Brauner, *supra* n. 1, at 79–81; Ramon Tomazela, *A Critical Evaluation of the OECD's BEPS Project*, 79(3) Tax Notes Int'l 239–240 (2015).

82 For a detailed overview *see* e.g. R. A. de Boer & O. C. R. Marres, *BEPS Action 2: Neutralizing the Effects on Hybrid Mismatch Arrangements*, 43(1) Intertax 14–41 (2015). On the concept of 'disparities' in the context of EU tax law, *see* B. J. M. Terra, P. J. Wattel, *European Tax Law* 93–94 (Kluwer Law International 2012).

83 *See* M. A. Kane, *Strategy and Cooperation in National Responses to International Tax Arbitrage*, 53(1) Emory L.J. 159–165 (2004). Cf. also the discussion undertaken in the context of EU state aid rules on whether the Netherlands facilitated the usage of hybrid arrangements, in De Boer & Marres, *supra* n. 82, at 35.

84 Compare also Faulhaber, *supra* n. 34, at 351.

recommended the use of 'linking rules' at the level of domestic tax law, further reinforced with a number of rules targeting specific types of tax treaty abuse.[85]

By a similar token, within BEPS Action 3, the OECD calls for strengthening the rules on CFC, which are found in the domestic laws of a number of countries. Simply put, it has been recognized that effective CFC rules constitute another key element in curbing BEPS, complementing other instruments, for example in the area of transfer pricing.[86] It seems that there is consensus in the literature that if effective CFC regimes were introduced worldwide, tax competition would be stifled to a significant extent, since MNCs would no longer have an incentive to incorporate subsidiaries in low-tax countries and shift profits there.[87] In this respect, the final outcome of BEPS Action 3 is rather weak, since it boils down to recommendations for 'best practices' in the design of a CFC regime to be implemented at the domestic level.[88] It effectively involves even more optionality than in the case of hybrids, reflecting deep political rifts between governments on this matter.[89] For example, developing countries, being traditional importers of capital, may see the reinforcement of CFC rules as undesirable from the overall perspective of the allocation of taxing rights, consequently declining to follow the OECD's recommendations.[90] This lack of consensus at a global level seems even more problematic considering that the presence and/or the exact design of a CFC regime in a particular jurisdiction may offer significant tax planning opportunities in the post-BEPS landscape.

A similar 'best practices' approach also permeates BEPS Action 4, dealing with the phenomenon of base erosion via interest deductions and intra-group finance arrangements, which is actually among the simplest forms of MNCs' tax planning.[91] In addressing this issue, the OECD has recommended the use of a 'fixed ratio rule' based on the EBITDA (earnings before interest, taxes, depreciation, and amortization) earned by individual entities belonging to a multinational group, supplemented by a 'worldwide group ratio rule'.[92] In very simple terms, interest deductions would be allowed for CIT purposes only to the extent these predefined thresholds are not exceeded, thus curbing excessive base erosion via manipulating levels of debt within MNCs. Again, every country is in principle free to decide whether to implement such rules in its domestic legislation – with the important exception of EU Member States, as explained further in this section – raising familiar concerns over the potential lack of coordination. However, since the announcement of the BEPS Action 4 recommendations in 2015, a number of countries have adopted interest deduction restrictions,-[93] thus confirming predictions of a higher degree of policy convergence in this matter as compared to some other items of the BEPS Action Plan.[94]

As noted above, a further component of the 'coherence arm' of the BEPS project is related to a new approach to the abuse of tax treaties, developed within BEPS Action 6. While we will not delve into the all-important technical niceties of the newly designed rules, such as the principal purpose test (PPT) or the limitation-on-benefits (LOB) rule, it is important to note that the final outputs of BEPS Action 6 belong to BEPS minimum standards. Accordingly, their implementation by the members of the Inclusive Framework – primarily via the MLI – is subject to monitoring and peer review.[95] All in all, the OECD's work within BEPS Action 6 amounts to a classic example of standard-setting at the international level, with double-sided effects: first, it forces countries to employ a more stringent approach to tax treaty abuse; second, it makes some types of tax planning by MNCs – for example, the use of intermediate holding companies – much riskier and prone to challenges by tax authorities.[96]

Regarding the above-discussed dichotomy between soft- and hard-law approaches to international tax governance, it is essential to underscore that, on the face of it, only the outcomes of BEPS Action 6 – belonging to minimum standards – involve a hard-law element in the form of a monitoring and

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85 *See* OECD, *supra* n. 74.

86 *See ibid*., at 14. More on this point *see* D. Blum, *Controlled Foreign Companies: Selected Policy Issues – or the Missing Elements of BEPS Action 3 and the Anti-Tax Avoidance Directive*, 46(4) Intertax 297–298 (2018).

87 *See* Blum, *supra* n. 86, at 297–300; A. P. Dourado, *The Role of CFC Rules in the BEPS Initiative and in the EU*, 60(3) Brit. Tax Rev. 354–355 (2015); Faulhaber, *supra* n. 34, at 351; Saint-Amans & Russo, *supra* n. 71, s. 2.1; Collier & Maffini, *supra* n. 32, at 32.

88 *See* A. Athanasiou, *BEPS Action 3: Final CFC Report Leaves Options Open*, Tax Notes Int'l 113–115 (12 Oct. 2015).

89 *See* Panayi, *supra* n. 78, at 633.

90 Dourado, *supra* n. 87, at 355–356.

91 *See* M. Tell, *Interest Limitation Rules in the Post-BEPS Era*, 45(11) Intertax 750–752 (2017).

92 *See* OECD, *supra* n. 72, at 25–28.

93 *See* OECD, *supra* n. 12, at 21.

94 *See* e.g. Brauner, *supra* n. 1, at 90–91.

95 For a recent report on this *see* OECD, *Prevention of Treaty Abuse – Peer Review Report on Treaty Shopping: Inclusive Framework on BEPS: Action 6*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2019), https://doi.org/10.1787/9789264312388-en (accessed 27 Jan. 2020).

96 *See* Collier & Maffini, *supra* n. 32, at 31.

peer review process within the Inclusive Framework. Furthermore, since the new standards against tax treaty abuse have been translated into a hard law instrument such as the MLI, they will inevitably take effect as more and more countries complete the ratification of the MLI in the time ahead. Conversely, the measures proposed in Actions 2, 3, and 4 seem rather 'soft', in that they mostly amount to best practices developed by the OECD. However, there are at least two caveats here. First, regarding BEPS Action 2, some of the anti-hybrid rules have also been translated into the MLI articles, with country signatories at liberty to opt-in.[97] Second, and more importantly, the contents of action items 2, 3, and 4 have gained binding force vis-à-vis EU Member States. New standards on interest limitation, CFCs and hybrid arrangements have been included in the EU Anti-Tax Avoidance Directive (ATAD),[98] with each of the twenty-eight EU Member States under the obligation to transpose relevant provisions in its domestic legislation, within the specified timeframe. Accordingly, soft BEPS standards have been converted into hard rules, adjusted to the tenets of the EU internal market and applicable in the territory of every EU Member State.[99]

Against this backdrop, it is safe to conclude that the new BEPS 'coherence standards' complement the work on harmful tax competition analysed in section 3.1. By tackling the phenomenon of double non-taxation, these measures not only narrow down the scope for tax avoidance by MNCs, but also push individual governments to legislate in the CIT area in a more coordinated and uniform fashion.

4 'Real tax competition' and the initiative for a global minimum tax

As may be derived from the discussion in the previous section, a number of measures developed by the OECD within the BEPS initiative may be labelled as being both 'anti-avoidance' and 'anti-competitive'. From the perspective of the present article, it is imperative to note how the above-depicted developments – e.g. redefined criteria for harmful tax practices, anti-hybrid rules, etc. – exert considerable influence on the international tax regime 'post-BEPS' in that most States have to abide by new minimum standards in their legislative activities in the area of CIT, and MNCs are disincentivized from engaging in specific tax planning schemes.[100]

On the other hand, a number of commentators have been quick to voice their concerns about the limits of such an approach. Summing up this criticism, while the new global standards promoted by the OECD undoubtedly confine competitive state behaviour within a set of agreed boundaries, it is reasonable to expect that many state actors would respond with further *tax rate* competition.[101] In other words, in the international tax landscape post-BEPS we may witness only a shift in the arenas of tax competition, with further 'race to the bottom' pressures.[102] This argument has been picked up even by the International Monetary Fund (IMF), which in a recent policy paper devoted to the future of CIT in the global economy issued a telling warning on the limits of BEPS outputs hitherto:

> *Current initiatives, focused on 'harmful tax practices' (offering preferential tax treatment to firms without economic substance), leave some open questions (…) potential tax savings may be so large that companies are willing to allocate whatever resources are needed to pass a substance test, however unproductive they truly are in that use; and tax competition becomes focused on attracting real activities. This reflects inherent limitations in addressing tax competition only in the form of specific regimes; it is increasingly recognized that low/zero taxation have adverse spillover effects.*[103]

Indeed, any serious inquiry into the state of international tax post-BEPS has to carefully assess the effects of new rules and standards on both 'virtual tax competition' – i.e. intercountry competition for profits that are shifted across national borders without corresponding real economic substance – and on the 'real tax competition', i.e. the competition for locations of real economic investment, such as tangible and intangible assets, key functions, key staff, etc.[104] Accordingly, it seems that the outputs of BEPS Actions 2 to 6 – as depicted above (section 3) – target only the former, while leaving the latter at the discretion of

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[97] *See* Arts 3, 4, and 5 of the MLI.

[98] Council Directive (EU) 2016/1164 of 12 July 2016 laying down rules against tax avoidance practices that directly affect the functioning of the internal market, OJ L 193/1 (19 July 2016).

[99] For a detailed technical analysis of the complex interaction between BEPS outputs and EU tax law *see* various chapters in Pistone & Weber, *supra* n. 56.

[100] *See* the discussion in *supra*, s. 3.

[101] *See* e.g. Keen, *supra* n. 38, at 222; Collier & Maffini, *supra* n. 32, at 50–51; Faulhaber, *supra* n. 34, at 357. Cf. also earlier discussion in P. Dietsch, *Catching Capital: The Ethics of Tax Competition* 87–88 (Oxford University Press 2015).

[102] *See* Faulhaber, *supra* n. 34, at 357.

[103] International Monetary Fund, *supra* n. 35, at 12.

[104] *See* Dietsch, *supra* n. 101, at 87–88. Cf. also the discussion in Keen, *supra* n. 38, at 223; L. van Appeldoorn, *BEPS, Tax Sovereignty and Global Justice*, 21(4) Critical Rev. Int'l Soc. & Pol. Phil. 3–4 (2016).

individual states. From an academic point of view, this may be seen as a reflection of the 'value creation' mantra that permeates the whole BEPS project. In essence, the rather vague notion of value creation requires that income is taxed in countries where economic activities linked with the derivation of income are taking place.[105]

Accordingly, the substantive action items of BEPS were primarily focused on curbing the artificial segregation of locations where income is being reported for tax purposes from locations where underlying economic activities are taking place. At the same time, the OECD apparently did not see low effective taxation as a problem in its own right, as long as the proper outcome of tax allocation – i.e. the outcome in line with the notion of value creation – has been attained. As put in the BEPS Action Plan of 2013:

> *BEPS relates chiefly to instances where the interaction of different tax rules leads to double non-taxation or less than single taxation. It also relates to arrangements that achieve no or low taxation by shifting profits away from the jurisdictions where the activities creating those profits take place. No or low taxation is not per se a cause of concern, but it becomes so when it is associated with practices that artificially segregate taxable income from the activities that generate it.*[106]

Put differently, the OECD's work within BEPS has focused on identifying the right place – or rather the right jurisdiction – where profits should be taxed, leaving aside the separate question of the right amount of tax that has to be borne by individual items of cross-border income.[107] The latter question has been treated as a *domaine réservé* of domestic legislators. As pointed out above, the downside of such an approach is the potential intensification of tax competition for real economic activities.

4.1 *Global Minimum Tax Under BEPS Action 1: General Issues*

It is precisely against the background of the preceding discussion on the limitations of BEPS measures in the face of 'real tax competition' that the recent developments regarding 'global minimum taxation' come to the fore. What is meant here by 'global minimum tax' is a regime ensuring that cross-border corporate profits are subject to a certain minimum ETR, irrespective of which State has the primary taxing right.[108]

Unlike the BEPS-related measures discussed previously (section 3), hitherto no concrete single model for a global minimum tax has been conclusively endorsed by the OECD, not even in the form of 'best practices' or 'recommendations'. However, this idea currently ranks high on the agenda of the BEPS Inclusive Framework, ever since its somewhat surprising appearance in January 2019, within the OECD's Policy Note on potential solutions to the tax challenges posed by the digital economy.[109] It has to be noted that the introduction of a global minimum tax was publicly endorsed by Germany and France in 2018, even if without any technical specification of the proposed regime.[110]

More importantly, the impetus in this regard was provided by the US tax reform adopted in late 2017, with significant changes to its domestic rules governing the taxation of cross-border income.[111] In this regard, two new elements of US tax legislation deserve attention: first, under 'global intangible low-taxed income' (GILTI) rules, income earned by foreign branches and/or controlled entities of US taxpayers is immediately taxed at the shareholder level at a certain rate, provided that it is not subject to a certain minimum effective tax burden in the local jurisdiction[112]; second, the 'base erosion and anti-abuse tax' (BEAT) is

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105 For a general discussion on the principle of value creation in the context of BEPS, *see* S. Morse, *Value Creation: A Standard in Search of a Process*, 72(4/5) Bull. Int'l Tax'n 196–202 (2018); J. Hey *'Taxation Where Value Is Created' and the OECD/G20 Base Erosion and Profit Shifting Initiative*, 72(4/5) Bull. Int'l Tax'n 203–208 (2018); M. Lennard, *Act of Creation: The OECD/G20 Test of 'Value Creation' as a Basis for Taxing Rights and its Relevance to Developing Countries*, 25(3) Transnational Corporations 76–80 (2018); F. Vanistendael, *An Octogenarian on Value Creation*, 90(13) Tax Notes Int'l 1385–1388 (2018); M. Devereux & J. Vella, *Value Creation as the Fundamental Principle of the International Corporate Tax System*, European Tax Policy Forum Policy Paper (July 2018), https://ssrn.com/abstract=3275759 (accessed 27 Jan. 2020); J. VanderWolk, *Digital Business and Corporate Income Taxation: Is Value Creation's Role Overstated?*, 92(8) Tax Notes Int'l 36–40 (2018).

106 OECD, *supra* n. 4, at 10.

107 Compare also the analysis in J. Englisch, *Global Anti-Base Erosion Proposal – General Views*, presentation at the OECD/G20 Inclusive Framework's Public consultation on the tax challenges of digitalisation (14 Mar. 2019), https://www.oecd.org/tax/beps/public-consultation-tax-challenges-of-digitalisation-13-14-march-2019.htm (accessed 27 Jan. 2020).

108 For a general introduction to a minimum tax regime *see* e.g. International Monetary Fund, *supra* n. 35, at 21; R. Azam, *Minimum Global Effective Corporate Tax Rate as General Anti-Avoidance Rule*, 8(6) Columbia J. Tax L. 27–28 (2017); D. N. Shaviro, *Fixing U.S. International Taxation* 191–193 (Oxford University Press 2013).

109 OECD, *Addressing the Tax Challenges of the Digitalisation of the Economy – Policy Note* (OECD Publishing 2019), https://www.oecd.org/tax/beps/policy-note-beps-inclusive-framework-addressing-tax-challenges-digitalisation.pdf (accessed 27 Jan. 2020).

110 *See Franco-German Joint Declaration on the Taxation of Digital Companies and Minimum Taxation* (2018), https://www.consilium.europa.eu/media/37276/fr-de-joint-declaration-on-the-taxation-of-digital-companies-final.pdf (accessed 27 Jan. 2020).

111 *See* Y. Brauner, *Editorial: Developments on the Digital Economy Front: Progress or Regression?*, 47(5) Intertax 423 (2019).

112 This is arguably an oversimplified description of the basic effects of GILTI regime. For a detailed analysis of pertinent rules *see* J. L. Cummings, Jr., *GILTI Puts Territoriality in Doubt*, Tax Notes (9 Apr. 2018); D. W. Blum, *The Proposal for a Global Minimum Tax: Comeback of Residence Taxation in the Digital Era?: Comment on Can GILTI + BEAT = GLOBE?*, 47(5) Intertax 516–518 (2019).

imposed if a US corporation excessively reduces its taxable base via base-eroding payments (e.g. interest, royalties, etc.) made to its associated non-US entities, effectively operating as a minimum tax on outbound payments.[113]

Against this background, a more detailed elaboration of a global model for minimum tax has been included in the OECD's May 2019 'work programme' on tax challenges of digitalization, which has quickly been labelled as the 'BEPS 2.0' initiative.[114] In line with the analytical framework envisaged in the earlier BEPS Action 1 documentation,[115] the proposal for a global minimum tax – dubbed as the global anti-base erosion proposal (GLOBE) – constitutes Pillar Two of the envisaged consensus-based, long-term solution to tax challenges posed by digitalization.[116]

In an apparent nod to the US rules on GILTI and BEAT, there are two parts to GLOBE:

(1) a minimum tax on outbound investment, taking the form of an 'income inclusion rule', complementing – as do the GILTI rules in the US – the regular CFC rules of the jurisdiction in question[117];
(2) a minimum tax on inbound investment, taking the form of either a denial of deduction (deduction barrier) for outbound base eroding payments or the imposition of a withholding tax at source on such payments, notwithstanding existing tax treaty obligations.[118]

4.2 *Policy Aspects of GLOBE as a Regulatory Instrument*

Regarding the rationale of GLOBE, the OECD makes clear that it 'seeks to address the remaining BEPS risk of profit shifting to entities subject to no or very low taxation'.[119] Describing GLOBE as 'a systematic solution designed to ensure that all internationally operating businesses pay a minimum level of tax',[120] the OECD offers two policy arguments for its introduction. First, GLOBE is predicted as a multilateral, consensus-based model of taxation, necessary to avoid the further proliferation of unilateral, uncoordinated actions targeted at taxing digital businesses.[121] Second, the anti-competitive nature of GLOBE is explicitly acknowledged, with the aim of curbing the harmful race to the bottom in attracting a CIT base, which disproportionately affects developing countries.[122] It is interesting to note here how the latter argument resonates with some earlier scholarly pleas for a global minimum tax as an instrument to attain the principle of 'fiscal state-determination'.[123] This point is extremely important, since it allows us to appreciate how the minimum tax approach – but also other anti-competitive measures analysed above in this article – may actually lead to a 'restoration' of States' capacity to effectively tax cross-border income, even if prima facie GLOBE may be seen as a sovereignty-limiting instrument. Linking this line of thinking with the debate on tax incentives, the OECD notes:

> Depending on its ultimate design, the GLOBE proposal could effectively shield developing countries from the pressure to offer inefficient incentives and in doing so help them in better mobilising domestic resources by ensuring that they will be able to effectively tax returns on investment made in their countries.[124]

Furthermore, the OECD unambiguously states that the two-pronged rules on GLOBE 'are intended to affect behaviour of taxpayers and jurisdictions alike which is expected to limit the revenue impact of rule order for jurisdictions'.[125] This explicit reference to the behavioural effects is a key point for analysis in the present article, revealing the potential importance of a global minimum tax regime as a

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[113] Again, on the analysis of technical details of BEAT, *see* M. Herzfeld, *Can GILTI + BEAT = GLOBE?*, 47(5) Intertax 510–513 (2019); M. M. Levey et al., *Country Note: Taking Stock of US 'Tax Reform' as the Dust Settles*, 46(4) Intertax 352–354 (2018).

[114] OECD, *supra* n. 12. For an overview of the differences between BEPS 2.0 and earlier work of the OECD in this area *see* e.g. D. Liu, J. Reyneveld & C. Straatman, *OECD's Work on the Digital Economy: Impact Far Beyond the Digital Economy*, 26(5) Int'l Transfer Pricing J. (2019).

[115] *See* in particular OECD, *Addressing the Tax Challenges of the Digital Economy, Action 1 – 2015 Final Report*, OECD/G20 Base Erosion and Profit Shifting Project (OECD Publishing 2015), https://doi.org/10.1787/9789264241046-en (accessed 27 Jan. 2020).

[116] *See* OECD, *supra* n. 12, at 8.

[117] *See ibid*., at 26–30.

[118] *See ibid*., at 26–30.

[119] *Ibid*., at 25.

[120] *Ibid*., at 26.

[121] *Ibid*., at 25–26. On this point, it is sufficient to consider the introduction of the so-called Diverted Profits Tax (DPT) in 2015 in the United Kingdom (UK) or the Indian 'equalization levy', introduced in 2016. For more on these measures *see* e.g. H. Self, *The UK's New Diverted Profits Tax: Compliance with EU Law*, 43(4) Intertax (2015); S. Wagh, *India/OECD – The Taxation of Digital Transactions in India: The New Equalization Levy*, 70(9) Bull. Int'l Tax'n (2016).

[122] OECD, *supra* n. 12, at 25–26.

[123] *See* Dietsch, *supra* n. 101, at 184; M. Ronzoni, *Global Tax Governance: The Bullets Internationalists Must Bite – And Those They Must Not*, 1(1) Moral Philosophy and Politics 53 (2014); Van Appeldoorn, *supra* n. 104, at 7.

[124] OECD, *supra* n. 12, at 26.

[125] *Ibid*.

regulatory instrument in the international tax framework. Indeed, in a global minimum tax scenario, MNCs' incentives to engage in profit shifting are significantly reduced, since such activities no longer bring the same marginal gains.[126] Concurrently, the imposition of a minimum tax burden on outbound investment effectively sets a floor on (real) tax competition, signalling to States that further reductions in CIT would not result in attracting a larger portion of the global tax base.[127] As noted by Faulhaber, '(A) minimum tax shifts competition from effective rates to anything else, including infrastructure, rate of return, legal protection, or other elements on which an investor might base its investment decisions'.[128] Accordingly, there are significant advantages of this approach from the perspective of tax efficiency. Put simply, by effectively reducing the differentials in after-tax returns across different countries, minimum tax enhances the overall level of international capital allocation.[129]

At this moment, it is far too early to predict the fate of the GLOBE proposal, or the whole BEPS 2.0 exercise for that matter, since further developments at the level of the Inclusive Framework are expected in 2020 at the earliest.[130] However, it is clear that it signifies a true game changer for the international tax regime,[131] in that its adoption would entail an unprecedented exercise in international tax coordination, underpinned by the understanding of the majority of sovereigns that it serves their respective self-interests.[132]

4.3 *Drawing Lessons for GLOBE from Subnational Taxation: The Example of the German Gewerbesteuer*

While currently there are no instruments comparable with GLOBE at the international level, some conclusions might be drawn from intra-state experiences. An interesting example of the regulatory effects of minimal taxation can be found in the historic development of the German trade tax (*Gewerbesteuer*), i.e. a local tax that is linked to trade income. At the first step, the basis of trade income is determined and then the assessment rate is applied.[133] While the determination of the basis follows nationwide uniform rules defined in the Trade Tax Act (*Gewerbesteuergesetz*),[134] the rate is defined directly by the municipalities.[135] As such, it was intended to be an expression of municipal autonomy that should allow for limited tax rate competition.[136] Some municipalities, however, decided to apply a zero assessment rate, effectively granting taxpayers tax exemption from trade tax on their territory.[137] They were then able to rely on other fiscal duties, not related to the (trade) income of the relocated corporations, as sources for public funding.[138] Understandably, larger municipalities and cities could not compete with zero assessment rates, as zero-rate municipalities usually did not have to provide real infrastructure for most of the registered businesses which had their real place of business or the majority of customers in other parts of Germany. The freedom of municipalities to freely adjust the tax burden in connection with the lack of a substantial business nexus requirement in effect allowed for unfair tax competition.[139] In response, the German legislator, instead of focusing on nexus requirements, introduced a minimum assessment rate of 200%.[140] Since then, the average assessment rates in Germany have stabilized at well over 200% and have even continued to increase,[141] and while some municipalities still use competitive assessment rates as a way of attracting businesses, even they nowadays rely heavily on trade tax revenues, trying to strike a balance between the funding of public services and the burdening of taxpayers.[142]

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126 *See* J. Englisch & J. Becker, *International Effective Minimum Taxation – The GLOBE Proposal* 5 (11 Apr. 2019), https://ssrn.com/abstract=3370532 (accessed 27 Jan. 2020).

127 Englisch & Becker, *supra* n. 126, at 6. Cf. also OECD, *supra* n. 12, at 27.

128 Faulhaber, *supra* n. 34, at 357.

129 Englisch & Becker, *supra* n. 126, at 5.

130 *See* OECD, *supra* n. 12, at 7.

131 *See* Blum, *supra* n. 112, at 522.

132 *See* Keen, *supra* n. 38, at 221.

133 DE: § 16 para. 1 Trade tax act from the 15 Oct. 2002 (BGBl. I S. 4167), last changed 11 Dec. 2018 (BGBl. I S. 2338).

134 DE: § 7 f. Trade Tax Act.

135 DE: § 16 para. 1 and § 4 Trade Tax Act. *See* A. Bergemann & J. Wingler, *Gewerbesteuer – GewStG: Kommentar* 696 (Springer-Verlag 2011).

136 See on this purpose, especially with regard to the argumentation of low tax municipalities, M. Faber, *Die Kommunen zwischen Finanzautonomie und staatlicher Aufsicht – Vorgaben zur Einnahmenoptimierung und Ausgabenkontrolle in der Haushaltssicherung* (Lit. 2012), at 50.

137 Faber, *supra* n. 136, at 23.

138 *See* the decision of DE: Constitutional Court BVerfGE112, 216, at 218.

139 Faber, *supra* n. 136, at 49.

140 DE: § 16 para. 4 Trade tax act.

141 *See* on this e.g. U. Wagschal, J. Wolfersdorff & K. Andrae, *Update Gewerbesteuer und Grundsteuer: Steuerentwicklung, Steuerwettbewerb und Reformblockaden*, ifst-Schrift 508 (2016), at 63 f.

142 *See* e.g. the analysis in J. Lemmer, *Wie wirkt Steuerwettbewerb auf kommunaler Ebene? Das Beispiel der Stadt Monheim am Rhein*, DSi kompakt, No. 24 (DSi – Deutsches Steuerzahlerinstitut des Bundes der Steuerzahler 2016), at 2 f.

This example of minimum taxation at a subnational level confirms that the model of alternative minimum taxation is not about stopping the race to the bottom, but rather about redefining the bottom. When a certain threshold for a minimum ETR is defined, all relevant stakeholders have an interest to come as close to the threshold as possible. From the viewpoint of corporate taxpayers, there is no benefit in getting a lower rate of tax than the threshold level, but their interest lies in achieving a tax burden as close as possible to this level. Furthermore, States that apply minimum tax rules have an incentive to set effective tax burdens at least at the level of the threshold rate, since the adoption of a lower rate will only result in a revenue loss in favour of other countries.[143] To sum up, the regulatory function of global minimum tax manifests itself in redefining the thresholds for malleable concepts such as 'acceptable' or 'legitimate' tax competition and tax planning, thus also shaping the behaviour both of States and taxpayers.

5 Conclusion

International tax rules are products of the interplay between tax competition and tax coordination, with individual states making rational policy choices on the basis of the benefits expected from a particular path of action. While this puts a number of complex issues before policymakers around the globe, it is well established that at least some degree of cooperation between States is necessary in order to set the limits for corporate tax competition. This type of collective action is essentially about setting the common standards on what kind of tax incentives and other state practices may be considered acceptable. This article has argued that it is precisely here that the regulatory purpose of international tax law plainly manifests itself. Accordingly, an attempt has been made to articulate and delineate the capacity of internationally developed rules and standards to affect the behaviour of both MNCs in arranging their cross-border activities and the States in designing their CIT systems.

In doing so, special emphasis has been put on the outputs of the BEPS project, being an unprecedented exercise in tax coordination. Indeed, this seems a timely moment for tax scholarship to pose fundamental questions on whether and to what extent the time-honoured principles of an international tax regime have changed or been reformed. For the purpose of the present article, specific components of the BEPS initiative have been identified as exponents of the regulatory function of international tax law, which is being asserted with new vigour in the aftermath of BEPS.

Undoubtedly – and as in the other fields of international law[144] – these developments may be ascribed to new societal challenges that may not be controlled and tackled adequately by unilateral, uncoordinated state action. The paramount challenge in the international tax context has been widespread tax avoidance by MNCs and other highly mobile taxpayers, with the consensus of major policymakers that something has to be done in this regard. As shown in the paper, the regulation of tax avoidance on the international plane indeed goes hand in hand with the regulation of tax competition, and pertinent anti-avoidance standards also bear witness to the new regulatory dynamism in international tax law. For example, the new BEPS 'coherence standards', aimed at the phenomenon of double non-taxation, not only narrow the scope for tax avoidance behaviour, but also push individual governments to legislate in the CIT area in a more coordinated fashion.

Perhaps the most valuable insight emerging from the analysis presented in this article is how GLOBE – proposed under Pillar Two of BEPS 2.0 – embodies a true paradigm shift, in that the model of minimum taxation essentially targets 'real tax competition', or competition for attracting real, rather than purely artificial, economic activities. Put differently, Pillar Two moves the debate from defining 'where to tax' to the issue 'at which (minimum) rate should the tax be imposed'. This fits in well with some of the scepticism raised in the international tax community on the compatibility between the measures envisaged under BEPS 2.0 with the outputs of BEPS 1.0, most of which are still in the early implementation stage.[145]

In any case, global minimum tax represents a powerful regulatory tool in that it sets the floor on tax competition and reduces the incentives for MNCs to engage in profit shifting. While a more detailed inquiry into the benefits of GLOBE are left for another study, its adoption at the multilateral level – however politically unrealistic that may seem – appears to be a viable alternative to other instruments currently wielded in the debate on the future of cross-border taxation. Whether it will really constitute a keystone of the new, post-BEPS, international tax regime remains to be seen.

Notes

[143] *See* Englisch & Becker, *supra* n. 126, at 5–6.

[144] *See* Cogan, *supra* n. 65, at 329–330.

[145] *See* particularly on how the new nexus and profit allocation rules under Pillar One depart from the time-honoured norms of international tax law, including the arm's length principle, Liu, Reyneveld & Straatman, *supra* n. 114, s. 4; L. Eden & O. Treidler, *Insight: Taxing the Digital Economy – Pillar One Is Not BEPS 2 (Part I)*, Daily Tax Report (8 Nov. 2019), https://news.bloombergtax.com/daily-tax-report/insight-taxing-the-digital-economy-pillar-one-is-not-beps-2-part-1 (accessed 27 Jan. 2020).