jurisdiction. Therefore, to improve voluntary compliance in the digital economy, countries should adopt well-designed tax rules that: (i) reject arbitrary criteria; (ii) solve the problem of double or multiple taxation; (iii) reduce compliance costs; (iv) target tax avoidance behavior; and (v) counter the widespread perception of noncompliance in the digital economy.

Unfortunately, only the future will tell whether corporate income tax in its current form will survive the challenges raised by the digital economy.

## §2.07 CONCLUSIONS

The challenges raised by the digital economy have started a process of reconfiguring tax jurisdiction – which requires a more fluid definition of the geographic scope of legal provisions – to adapt tax rules to modern society.

In the past, the mere exploitation of the consumer market was considered insufficient to justify the levy of an income tax. On the contrary, only the jurisdiction in which the consumer market was located had the right to impose consumption taxes.

However, this concept of tax jurisdiction was connected with the origins of the international tax framework, where brick and mortar businesses dominated the economy. It was long before the current advances in the digital economy. Nowadays, the main proposals for taxing income derived from digital transactions attribute tax jurisdiction to the state where the consumer market is located. Thus, the exploitation of the consumer market has returned to the international agenda to be a proper connecting factor to assert tax jurisdiction related to income tax.

On the one hand, from a substantive jurisdiction perspective, the consumer market seems to be a legitimate connecting factor for the taxation of the digital economy. Countries should be entitled to tax income derived from sales made to their residents. Moreover, the concept of corporate residence has become meaningless while source taxation is based on an elusive criterion since the income does not have a single economic source.

On the other hand, from an enforcement jurisdiction perspective, it is extremely difficult to enforce tax liabilities of non-resident companies that do not have any assets within the country. This is the case in spite of the growing trend towards the exchange of information and international assistance in tax collection among countries. In addition, in several countries, in view of constitutional principles such as the due process of law, tax authorities cannot use indirect coercive measures to enforce their tax claims. For this reason, successful taxation of e-commerce transactions depends crucially on securing voluntary taxpayer compliance.

Therefore, countries should be very careful in designing tax rules to capture the income derived from e-commerce transactions. Voluntary compliance is essential in the digital economy. This requires well-designed tax rules in compliance with both substantive jurisdiction and enforcement jurisdiction.



CHAPTER 3

# Justification and Implementation of the International Allocation of Taxing Rights: Can We Take One Thing at a Time?

*Luís Eduardo Schoueri & Ricardo André Galendi Júnior*

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## §3.01 INTRODUCTION

In international taxation, it is impossible to segregate the debate on abusive behavior from the debate on the allocation of taxing rights. The Base Erosion and Profit Shifting (BEPS) Project is intended to kick this fact into the long grass and has been so far very successful in doing so.

The Action Plan announces that its "actions are not directly aimed at changing the existing international standards on the allocation of taxing rights on cross-border income."[1] The statement is rather subtle. At the same time, it asserts the commitment of the BEPS Project with privileging the current allocation of taxing rights, but acknowledges that the actions may affect it, even if, allegedly, they are not aimed at doing so. Changes in the allocation of taxing rights are thus treated as a collateral consequence of making taxpayers pay their fair share. The determination of the State to which such fair share will be paid is considered as a natural outcome of taxpayer compliance, demanding no further debate. The message is clear: make taxpayers pay their "fair share," and whatever arises from their compliance with the tax rules will be fair.

1. OCDE (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing, p. 11, available at http://dx.doi.org/10.1787/9789264202719-en, access on July 22, 2016.

Curiously enough, when one recalls the effervescence of public opinion with respect to tax avoidance,[2] when international media and several NGOs discussed whether the "fair share" was being paid, public's astonishment could be summarized on the fact that multinationals present in one jurisdiction were not paying taxes therein. This is more than merely pleading a "fair share" payment: there is also the idea that if a company acts within a market, then the latter should get taxes related therewith. In other words, the original movement towards the BEPS Project was motivated by the fact that, in the current regime, having access to the market is not sufficient to be liable to tax in the State of the market. The logic is very simple: people want the coffee company to be taxed where the coffee is drunk. Otherwise, they threaten not to drink the coffee.

It is doubtful whether merely making the company pay its fair share somewhere would make the coffee any less distasteful. Indeed, knowing that the company is paying taxes nowhere may make the consumer angry. However, announcing that the company is still not paying taxes in her/his State, but has started paying a huge amount of taxes somewhere else in another continent, would hardly bring any relief to her/his feelings of injustice.

The present chapter aims at analyzing how the BEPS Project has managed to divert the debate from such a central point as the allocation of taxing rights. For this purpose, in section §3.02, a historical evolution of the prevalent normative arguments in international taxation is proposed. The authors pose that economic allegiance, economic neutrality, and now cooperation against abusive behavior have all been used as grounds to justify the preference for allocating tax jurisdiction to the State of residence, being the inconsistencies of such approaches often ignored. In section §3.03, the interaction of the current cooperative trend with the sovereignty of States is analyzed.

## §3.02 THREE WAVES OF JUSTIFICATION OF RESIDENCE TAXATION IN THE INTERNATIONAL TAX DEBATE

In one of his many outstanding articles, Professor Reuven Avi-Yonah has suggested that the history of U.S. international taxation could be divided into four periods: the "Age of Benefits (1918-1960)"; the "Age of Neutrality (1961-1980)"; the "Age of Competition (1981-1997)"; and the "Age of Cooperation (1998-)."[3] His division is based on the prevalent theoretical principle under which legislative enactments were debated in each one of the ages of U.S. international taxation.

2. For a comprehensive study on the role of NGOs and other "tax activists" in the current international tax debate, *see* A. Christians, "Tax activists and the global movement for development through transparency," *in* Y. Brauner and M. Stewart (ed.) *Tax, Law and Development* (Edward Elgar Publishing, Massachusetts, 2013), pp. 288–315.
3. R. S. Avi-Yonah. "All of a Piece of Throughout: the four ages of U.S. international taxation," 25 *Virginia Tax Review* 313 (2005).





In the present section, the authors pose that these ages and their respective underlying principles correspond in a great extent to the evolution of the prevalent normative argument in international tax debates as a whole. Except for the Age of Competition,[4] each one of Avi-Yonah's ages brings a justification for the dominant allocation of tax jurisdiction, and a main compelling reason for States to adhere to the proposed system.

In the first wave of justification, in which the overall allocation of taxing rights was constructed, it was argued that States should adhere to a certain view of economic allegiance, because it would be a fair way to avoid the pervasive effects of juridical double taxation. In the second wave, during which the bilateral treaties network was expanded, it was suggested that States should adhere to a certain view of neutrality, because it would increase "efficiency" and "global welfare." Finally, in the third and current wave, in which a multilateral treaty is proposed, States are expected to adhere to certain terms of a proposed cooperation, in order to combat abusive behavior, namely the so-called "base erosion and profit shifting." The first two justifications are undoubtedly flawed, as widely acknowledged by contemporaneous scholarship, and there is no reason to conclude that the third wave is any less inconsistent.

Even though each of these three waves presents different reasoning and justifications, they were all developed to endorse a certain view on international taxation regarding the allocation of taxing rights, which has never substantially changed. Indeed, the BEPS Project, the most ambitious outcome of the third wave, follows the very same traditional interpretation of the first wave, being "hampered by the focus on residence jurisdiction for passive income and source jurisdictions for active income."[5]

The conclusion regarding the focus of the BEPS Project on residence taxation is neither new nor innovative. Among several other contributions, an incisive statement is made by Yariv Brauner, who denounced the prevalence of the "interests of the stronger economies" in the current allocation of taxing rights, which has been evolutionarily formed, without a clear global leadership. The "typical manifestation of this increasing dominance" would be the inescapable "trend toward more residence-based taxation at the expense of source taxation, as promoted by the OECD."[6]

However, it is essential to stress the importance of the discourse focused on "cooperation," "abusive behavior" and allocation of tax jurisdiction in line with "value creation" for the current debate. Like economic allegiance and neutrality before them, these keywords are central to contemporaneous international tax discussions and have diverted attention from topics in which inter-nations equity should be evaluated.

4. Even though competitiveness is a strong normative argument from the perspective of the domestic tax system, it does not correspond to the purpose of international relations, where the focus is on reaching an agreement between multiple parties. For the purposes of the present chapter, the "Age of Competition" is considered as the dawn of the Age of Neutrality, as it will be described below.
5. R. Avi-Yonah and H. Xu, Global Taxation After the Crisis: why BEPS and MAATM are inadequate responses, and what can be done about, *University of Michigan Public Law & Legal Theory Research Paper* (2016) No. 494, p. 5.
6. Y. Brauner. "What the BEPS," 16 *Florida Tax Review* 2 (2014), p. 63.



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### [A] Economic Allegiance and the Framing of Double Tax Treaties

The formative period of the overall allocation of taxing rights coincides with the first relevant initiatives of the U.S. international tax policy.[7] Both were influenced by (or at least justified under) the notion of economic allegiance, as means to allocate the taxation of an item of income to a given State. In this first wave, it was argued that States should adhere to a certain view of economic allegiance, because it would be a fair way to avoid the pervasive effects of double taxation.

The origins of the economic allegiance are often attributed to Von Schanz, according to whom anyone who has a connection with a certain State should also contribute to the costs of financing it. As narrated by Hongler and Pistone, based on such perception, "Von Schanz reached the conclusion that taxing powers should be retained by three quarters with the country of source and only the remaining part with the state of domicile."[8]

However, the main players of international taxation during the 1920s held a different interpretation of the theory. When investigating the economic allegiance between origin and domicile, the so-called Four Economists concluded that, ideally, all corporeal wealth, including immovables and tangible movables, except for money, jewelry, furniture, etc., should be allocated predominantly or wholly to the place of origin, whereas all intangible wealth, except for mortgages, should be assigned to the domicile or residence.[9] They recognized that the exact allocation would be "well-nigh impossible" and "savour too much of the arbitrary," but suggested that "a certain rough justice" could be reached by allocating all the categories of the first division to the place of origin and all of the second to the place of domicile. According to this logic, "[w]hat each country would lose in the one case it would roughly gain in the other, and there would be the great additional advantage of comparative simplicity."[10]

The report further recognizes that, with respect to the allocation of taxing rights, "it is not possible on the grounds of pure economic theory to indicate what proportions should actually be adopted," insinuating the limitations of the economic allegiance.[11] Hence, it suggests that "the proportion presenting a true compromise for country A and the rest of the world may be adopted which is inappropriate for the relations of country B to the rest of the world."[12]

Even considering such limitations, the conclusion of the report is that the reciprocal exemption of the non-resident would be the "most desirable method of avoiding the evils of double taxation" and should be adopted "wherever countries feel

7. R.S. Avi-Yonah. "All of a Piece of Throughout: the four ages of U.S. international taxation," 25 *Virginia Tax Review* 313 (2005), p. 318.
8. P. Hongler; P. Pistone. "Blueprints for a New PE Nexus to Tax Business Income in the Era of the Digital Economy," *IBFD White Papers*, Amsterdam, IBFD, 2015, p. 20.
9. Report on Double Taxation submitted to the Financial Committee By Professors Bruins, Einaudi, Seligman And Sir Josiah Stamp (Document E.F.S.73.F.19.; April 5, 1923), in 4 *Legislative History of United States Tax Conventions* 1962 (hereinafter "the Four Economists Report"), p. 4043.
10. *Id., Ibid.*
11. The Four Economists Report, p. 4050.
12. *Id., ibid.*





in a position to do so."[13] It regards that in cases where such method would be "repugnant," countries should make the best arrangement they could by allocating taxing powers via conventions. It also foresees that with the industrialization of developing countries, the distinction between debtor and creditor countries would become more tenuous and the principle of residence more widely understood.[14]

As summarized by Avi-Yonah, the importance of the Four Economists Report cannot be neglected: it was "the first work by representatives of capital exporting and importing countries to lay out the fundamental compromise underlying the treaty network," namely that "active (business) income should be taxable primarily at source, while passive (investment) income should be taxable primarily at residence."[15]

Another important contributor of the formation of the currently established allocation of taxing rights was Mitchell Carroll, who bears the title of the "principal mover behind the main limitation on source taxation in the League models, namely the permanent establishment."[16] This author managed to consolidate the understanding that, absent a permanent establishment, benefits conferred by the source State would not be sufficient to justify taxation,[17] also ignoring the relevance of demand for the creation of value.

As seen, the Four Economists were aware of the limitations of the economic allegiance analysis they proposed, and were very straight-forward with respect to its limitations. The debate has significantly evolved since them. Unlike the Four Economists proposal, contemporaneous scholarship have stressed the importance of the market for the creation of value. Kirchhoff notes that taxes provide means for the maintenance of the State. He argues that to the extent that the State is distanced by constitutional strength from the economic activity, by granting the individual power over economic goods, the State can only be financed through participation in the private economic wealth. Under this conception, taxes would be the State's participation in the economic success of individuals.[18] In Kirchhoff's theory, if an individual derives income, this is due both to her/his personal effort and to the existence of the market: it would be a waste of effort if there was not a market where one could act. Thus, the justification (and cause) of taxation lies in the fact that the State is financed through its participation in the individual success of private agents.[19] One notes, in this theory, that the author has a clear vision of the State as a representative of the

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13. The Four Economists Report, p. 4055.
14. *Id., ibid.*
15. R. S. Avi-Yonah. "All of a Piece of Throughout: the four ages of U.S. international taxation," 25 *Virginia Tax Review* 313 (2005), p. 322.
16. R. S. Avi-Yonah. "All of a Piece of Throughout: the four ages of U.S. international taxation," 25 *Virginia Tax Review* 313 (2005), p. 323.
17. M. B. Carroll, "International Tax Law: Benefits for American Investors and Enterprises Abroad," 2 *International Law* 692 (1968), p. 701.
18. *See* P. Kirchhof, Die verfassungsrechtliche Rechtfertigung der Steuer, in *Steuern im Verfassungsstaat: Symposium zu Ehren von Klaus Vogel aus Anlaß seines Geburtstags*, Paul Kirchhof et al., München, Beck, pp. 27–63 (32).
19. *See* P. Kirchhof, Die verfassungsrechtliche Rechtfertigung der Steuer, in *Steuern im Verfassungsstaat: Symposium zu Ehren von Klaus Vogel aus Anlaß seines Geburtstags*, Paul Kirchhof et al., München, Beck, pp. 27–63 (37 and 44).

community, being the tax the portion which the individual pays the community, for offering the conditions of his enrichment.

### [B] Neutrality and the Apogee of Bilateralism

From the 1960s on, any and every major discussion on international tax policy in the U.S. would be carried out under the neutrality paradigm, which led Reuven Avi-Yonah to speak of an "Age of Neutrality" in the U.S. international tax policy. In this wave, prevalent during the period of expansion of the bilateral tax treaty network, it was suggested that States should adhere to a certain view on neutrality, because it would increase "efficiency" and "global welfare."

Economic efficiency is the main idea behind neutrality.[20] Even though economic efficiency is mostly a matter of economics, the adequate comprehension of economic debates is often central for lawyers,[21] especially for tax lawyers, if they intend to understand the facts ruled by tax law. In international tax discussions, it is common to refer both to Capital Export Neutrality ("CEN") and Capital Import Neutrality ("CIN"), being the former usually addressed as an optimal measure for global welfare. Both the classification and the option for CEN instead of CIN as an efficiency standard have first appeared in a work from Peggy Musgrave, in 1963, under the title *The Taxation of Foreign Investment Income*.

Whilst the importance of Musgrave's contribution is uncontroversial, one may consider that, even before the systematization of the theory, its main underlying concepts were already taken into account for the purpose of tax reforms.[22] The grounds of such theory were inherited by generations of tax and public finance scholars, being for decades the dominant normative argument in political debates, mostly due to the strong influence of Stanley Surrey.[23] Indeed, even though Brazil signed a tax treaty with the U.S. in 1967, the treaty was later rejected by the U.S. Congress. The main argument against it was the existence of a tax sparing clause in the signed convention, against which there was a strong rejection in Congress, attributable to the position expressed by Stanley Surrey on the issue when the treaty with Pakistan was refused.[24] The position of the U.S. Congress on tax sparing has not changed since then.[25]

Another factor that contributed to such enthronization was the relatively reduced participation of lawyers in international tax debates in the U.S., mostly carried out

20. *See* L. E. Schoueri. *Direito Tributário*, (4th ed., São Paulo, Saraiva, 2014), p. 46.
21. *See* K. Vogel, "World-wide vs. Source Taxation of Income – A Review and Reevaluation of Arguments," *in* S; Mclure; Musgrave et al, *Influence of Tax Differentials on International Competitiveness* (Amsterdam Kluwer, 1989), pp. 117–166 (137).
22. For its historical importance in the U.S., *see* R. S. Avi-Yonah. "All of a Piece of Throughout: the four ages of U.S. international taxation," 25 *Virginia Tax Review* 313 (2005), pp. 313–318.
23. *See* R. S. Avi-Yonah. "All of a Piece of Throughout: the four ages of U.S. international taxation," 25 *Virginia Tax Review* 313 (2005), pp. 324–330.
24. *See* L. E. Schoueri, Contribuição à História dos Acordos de Bitributação: a Experiência Brasileira, 22 *Revista Direito Tributário Atual* (2008), pp. 267–287.
25. *See* L. E. Schoueri, "Tax sparing: a reconsideration of the reconsideration," *in* Y. Brauner and M. Stewart (ed.) *Tax, Law and Development* (Edward Elgar Publishing, Massachusetts, 2013), pp. 106–126.





under the argument of maximization of global welfare, and ignoring fairness, equity, and distributional concerns.[26]

#### *[1] The Rise of Neutrality: CEN and CIN as Welfare Benchmarks*

CEN refers to the decision of an agent to invest her/his country or in a third State. A tax system compliant with the CEN paradigm would be that in which the investor pays taxes at the same rate over income, irrespective of the location of the investment.[27] CEN is ultimately concerned with the decision of an agent to invest in the country or abroad.[28]

There are basically two ways of achieving CEN, either: (i) all countries tax the income of their residents in an universal basis, granting unlimited credit in relation to taxes paid in other countries (even if foreign taxes were higher than local ones); or (ii) all States harmonize their tax bases and tax rates.[29] As investors are always able to invest in their own country, CEN will be accomplished if income derived from investments made abroad is subject to the same tax burden as income sourced in the State.[30]

Tax rates differ substantially among countries and it has become generally accepted that the residence country has the right to tax at its own rate foreign investments made by its residents. The consequence is that it is up to the State to decide whether to implement CEN or not, by crediting taxes paid abroad. Worldwide basis taxation plus the adoption of the full credit method in domestic legislation would thus ensure CEN. Ideally, a system coherent with CEN would neither allow the deferral of taxation by the State of residence, nor impose any limit to credits concerning taxes paid abroad. The authors are not aware of the existence of a State admitting unlimited credit.

The economic concern with CEN is that, in case it is not followed, it is likely that assets will be located in the country where they will produce a greater return after taxation, and not in the country where they are more productive.[31] The underlying idea is that, if income earned is taxed at the same rate irrespective of the jurisdiction where the investment is made, enterprises will invest where their profits before taxation are

26. *See* K. Vogel, "World-wide vs. Source Taxation of Income – A Review and Reevaluation of Arguments," *in* S; Mclure; Musgrave et al, *Influence of Tax Differentials on International Competitiveness* (Amsterdam Kluwer, 1989), pp. 117–166 (118).
27. *See* M. S. Knoll, "The connection between competitiveness and international taxation," 65 *Tax Law Review* (2012), p. 363.
28. *See* M. Kane. "Ownership Neutrality, Ownership Distortions, and International Tax Welfare Benchmarks," 26 *Virginia Tax Review* (2006), p. 55.
29. *See* M. S. Knoll, "The connection between competitiveness and international taxation," 65 *Tax Law Review* (2012), p. 363; F. Shaheen. "International Tax Neutrality: Revisited," 74 *Tax Law Review* (2011), p. 131.
30. *See* J. Hines Jr. "Reconsidering the taxation of Foreign Income," 62 *Tax Law Review* (2009), p. 272.
31. *See* R. S. Avi-Yonah. "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State," 113 *Harvard Law Review* 7 (2000), pp. 1573–1676 (1605).



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higher.[32] Hence, considering that efficiency requires that economic agents make decisions irrespective of tax concerns, sponsors of CEN conclude that it promotes global welfare.

This is the traditional argument that has led economists to contend residence taxation as the optimal measure in international tax. Worldwide basis taxation assumes that, absent source taxation, the residence State will ensure CEN is kept.[33]

Some questionable assumptions are taken for granted by those who contend CEN as the optimal paradigm from a global welfare perspective. The first is that the State of residence will have incentives to increase tax revenues from taxation of profits of its companies. This premise does not take into consideration the efficiency costs from increasing tax collection from any source without further policy considerations. The CEN argument takes residence as something stable, which will not oscillate due to more advantageous alternatives, as the transference of residence to other jurisdictions.[34]

Second, it is assumed that the other States do not adopt tax policies of capital exporting countries. The choice of CEN as the optimal model assumes that States will ignore the reciprocal influences of tax policies among countries. As a consequence, the case for CEN is made without further consideration of how States actually behave. An ideal conduct is defended, without considering what in fact happens. CEN is sustained as a mechanism to increase efficiency, even though the actual behavior of States does not allow the alleged efficiency to be achieved at all.

Third, CEN supposes an ideal scenario where there are no other relevant economic distortions, such as other taxes[35] or substantial infrastructure differences among countries.[36] However, it should be considered that, in fact, national tax systems always include other taxes, which may justify reduced rates for incomes taxes. Also, ignoring differences in infrastructure amounts to incentivize companies to invest in developed countries. If there is a relation between tax burden and quality of public services, then developed countries tax income at higher rates, but also offer better public goods. In a scenario where CEN is privileged, the investor will only choose to invest in a developing country if her/his profits are high enough to overcome the differences of provision of public goods.[37]

Furthermore, CEN has never been truly implemented. If States believed that capital export should be neutral, then they should not only tax the positive difference

32. *See* J. Hines Jr. "Reconsidering the taxation of Foreign Income," 62 *Tax Law Review* (2009), p. 272.
33. *See* R. S. Avi-Yonah. "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State," 113 *Harvard Law Review* 7 (2000), pp. 1573–1676 (1605).
34. *See* J. Hines Jr. "Reconsidering the taxation of Foreign Income," 62 *Tax Law Review* (2009), p. 272.
35. *See* R. S. Avi-Yonah. "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State," 113 *Harvard Law Review* 7 (2000), pp. 1573–1676 (1609).
36. L. E. Schoueri. "Tax sparing: a reconsideration of the reconsideration," *in* Y. Brauner, M. Stewart. *Tax, Law and Development* (Edward Elgar Publishing, Massachusetts, 2013), pp. 119–120.
37. L. E. Schoueri. "Tax sparing: a reconsideration of the reconsideration," *in* Y. Brauner, M. Stewart. *Tax, Law and Development* (Edward Elgar Publishing, Massachusetts, 2013), p. 120.





in relation to taxes paid abroad, but also reimburse companies for the negative difference, which never seems to have happened.[38]

Affirming CEN as a welfare benchmark is to ignore the role of tax competition in tax policy design and to assume that all States are at similar levels of development and have made similar choices with respect to the role of the public sector, being thus able to provide similar public goods. Also, the argument lacks sincerity, since deferral and non-reimbursement of taxes have always been obstacles to the concreteness of the neutrality dream.

The normative argument against CEN was initially developed under the defense of CIN, which requires that income derived in a State is taxed at the same rate, irrespective of being derived by a resident or by a non-resident.[39] In order to preserve CIN, the investment shall be taxed at the same rate, regardless of the jurisdiction where the investor is a resident. CIN is essentially concerned with the decision to finance an investment with funds from the country or from abroad.[40]

In 1980, Thomas Horst published a seminal article[41] in which he argued that, while worldwide basis taxation would not distort the allocation of assets, territorial basis taxation would neutralize savings and investment behavior among countries. The author's conclusion is that, if all countries adopted territorial taxation, CIN would be achieved as savings neutrality, i.e., the system would not distort the decision of the investors from different State to spend or save. The critique made to CEN, in the sense that it would solely restrict international investments, cannot be reproduced with regard to CIN.[42] CIN is mostly about savings neutrality.

Horst also sustained that, since tax rates vary from country to country, it would be impossible to simultaneously achieve both CEN and CIN.[43] Avi-Yonah argues that, even though Horst was correct in 1980, his conclusion does not remain, since the convergence of tax rates would be currently feasible.[44]

### [2] *Drowning in the Alphabet Soup: CEN, CIN, CON, and Tax Inversions in the U.S.*

Even though CIN and CEN are intensively discussed in current international tax debates, the increasing of tax competition among countries has made these paradigms

38. L. E. Schoueri. "Tax sparing: a reconsideration of the reconsideration," *in* Y. Brauner, M. Stewart. *Tax, Law and Development* (Edward Elgar Publishing, Massachusetts, 2013), p. 120.
39. *See* R. S. Avi-Yonah. "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State," 113 *Harvard Law Review* 7 (2000), pp. 1573–1676 (1605).
40. *See* M. Kane. "Ownership Neutrality, Ownership Distortions, and International Tax Welfare Benchmarks," 26 *Virginia Tax Review* (2006), p. 55.
41. *See* T. Horst. "A note on the optimal taxation of international investment income," 94 *The Quarterly Journal of Economics* 4 (1980), pp. 793–798.
42. *See* L. E. Schoueri. "Princípios no Direito Tributário Internacional: territorialidade, fonte e universalidade." In: R. Ferraz (org.). *Princípios e limites da tributação*, (São Paulo, Quartier Latin, 2005), p. 362.
43. *See* T. Horst. "A note on the optimal taxation of international investment income," 94 *The Quarterly Journal of Economics* 4 (1980), pp. 793–798.
44. *See* R. S. Avi-Yonah. "Is it Time to Coordinate Corporate Tax Rates? A Note on Horst," *Public Law and Legal Theory Research Paper* Series, Paper No. 382 (2014), p. 1.



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less relevant.[45] The perception that tax competition influences domestic legislation and the behavior of taxpayers added complexity to the debate and made the argument in favor of international tax neutrality even more flawed. If, from a domestic policy perspective it makes sense to speak of an "Age of Competition," from the point of view of the overall international tax debates, this age is nothing more than the dawn of theoretical belief on capital exporting neutrality as a welfare benchmark.

Tax competition takes place when States seek to attract investments and potentially increase their tax revenues, by means of reduced taxation over commercial activities.[46] Tax competition is a form of regulatory competition.[47] The tax policy of a State may affect migration, investments, and tax planning. While low taxation is seen as investment and employment-inducing, high tax rates are considered to incentivize the opposite consequences.[48]

The first use of the expression "capital ownership neutrality" ("CON") is attributed to Devereux, who coined the expression to refer to a tax system which is neutral in relation to the property of capitals.[49] Desai and Hines Jr., in articles on tax neutrality,[50] developed the thesis that the effects of international tax policy over welfare should be measured considering not only the location of the investments, but also its property. According to this analysis, tax policy should take into account not only the jurisdiction where capital is saved or invested, but also the jurisdiction where the effective owner of such capital is located.

These authors reject the conclusion according to which an investment is equally productive irrespective of who are its owners. CON would be relevant to efficiency, because property is relevant to efficiency, which would be ignored by Musgrave's model.[51] Claiming to have overcome Musgrave's model with respect to global welfare, the authors even qualify as "older wisdom" the defense of CEN.[52] Indeed, the new theory has gained momentum and recent scholarship on the issue has at least considered CON when addressing tax neutrality.[53]

45. *See* R. A. Galendi Jr., "Fundamentos da Tributação de Lucros no Exterior: entre competitividade e harmonização, 33 *Direito Tributário Atual* (2015), pp. 389–412.
46. *See* J. Roin. "Competition and Evasion: Another Perspective on International Tax Competition," 89 *The Georgetown Law Journal* (2000), p. 545.
47. *See* M. S. Knoll, "The connection between competitiveness and international taxation," 65 *Tax Law Review* (2012), p. 355.
48. *See* M. S. Knoll, "The connection between competitiveness and international taxation," 65 *Tax Law Review* (2012), p. 365.
49. *See* M. Devereux. "Capital Export Neutrality, Capital Import Neutrality, Capital Ownership Neutrality and all that," *Institute for Fiscal Studies*, Working Paper No. 2 (1990).
50. The most important articles are: M. Desai; J. Hines Jr. "Evaluating International Tax Reform," 56 *National Tax Journal* (2003), pp. 487–502; M. Desai; J. Hines Jr. "Old Rules and New Realities: Corporate Tax Policy in a Global Setting," 62 *National Tax Journal* (2004), pp. 937–960.
51. *See* J. Hines Jr. "Reconsidering the taxation of Foreign Income," 62 *Tax Law Review* (2009), p. 275.
52. *See* J. Hines Jr. "Reconsidering the taxation of Foreign Income," 62 *Tax Law Review* (2009), p. 270.
53. *See*, e.g., M. Graetz and A. Warren Jr. "Income Tax Discrimination: Still Stuck in the Labyrinth of Impossibility," 121 *The Yale Law Journal* (2012), pp. 1118-1167; *See* M. Kane. "Ownership Neutrality, Ownership Distortions, and International Tax Welfare Benchmarks," 26 *Virginia Tax Review* (2006), passim; M. S. Knoll, "The connection between competitiveness and international taxation," 65 *Tax Law Review* (2012), passim.





CON is defined as an attribution of tax systems which keep incentives to the efficient property of assets.[54] A tax system compliant with CON is a system in which companies, irrespective of where they are located, compete on equal-footing for the acquisition of assets, in the sense that taxes do not affect their capacity of acquiring assets.[55]

There would be two main advantages of the CON paradigm when compared to Musgrave's model. The first one would be that the new formulation would consider the impact of economic distortions from other taxes. Second, CON would be able to incorporate the reactions of other States to changes in the taxation in the State of residence. The property of capital would be directly influenced by the tax policies of each State and such effects, if adequately measured, would have the potential to revert the Musgrave's conclusions regarding welfare.[56] In other words, CON would take the effects of tax competition over tax systems into account, being able to contemplate this element in the measurement of global welfare.[57]

CON demands that all countries tax similarly income derived by their residents abroad. If all States tax foreign income in a worldwide basis, using the credit method to avoid double taxation, CON will be privileged. In this case, there will be no tax incentive for the reallocation of assets among investors subject to different jurisdictions. The same would occur if all countries exempt their residents' foreign income. In such case, the applicable regime would be the same for all investors, and competition among potential buyers of assets would incentivize that they are held by the most productive owners.

The authors sustain that CON would be privileged either if all countries taxed income on a worldwide basis (CEN), or if they taxed income on a territorial basis (CIN). CON would also be contemplated if there was uniform adoption of any policy comprised in the gap between CIN and CEN, to which tax policies usually converge.[58]

The advent of CON was a clear academic response to the increasing of tax inversions in the U.S. As most jurisdictions migrated to territorial taxation of business profits, by means of participation exemptions,[59] along with other measures to attract investments and expand the activities of local companies abroad, the U.S. insisted on the CEN reasoning, in order to maintain the taxation of profits upon repatriation. This

54. *See* J. Hines Jr. "Reconsidering the taxation of Foreign Income," 62 *Tax Law Review* (2009), p. 275.
55. M. S. Knoll, "The connection between competitiveness and international taxation," 65 *Tax Law Review* (2012), p. 368.
56. *See* J. Hines Jr. "Reconsidering the taxation of Foreign Income," 62 *Tax Law Review* (2009), p. 271.
57. For a position considering national welfare instead of global welfare, *see* D. Shaviro, "Rethinking foreign tax creditability," *National Tax Journal*, vol. 63, 2010, pp. 709–722.
58. *See* J. Hines Jr. "Reconsidering the taxation of Foreign Income," 62 *Tax Law Review* (2009), p. 276.
59. J. Englisch. "Fiscal cohesion in the taxation of cross-border dividends (part one)," *European Taxation* (2004), p. 323. C. Romano. "Holding companies regimes in Europe: a comparative survey," *European Taxation* (1999), pp. 256–269.



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led to major tax inversions of U.S.-based multinational enterprises,[60] in transactions involving billions of dollars and eroding the U.S. tax base. Ironically, such *tax* inversions are clearly tax driven, despite the strong commitment of the U.S. with neutrality.

### [C] Cooperating for Value Creation

Wisely conceiving that "[p]eriodization becomes more and more difficult as one approaches the present," Avi-Yonah suggests that, in the U.S. tax policy "a new period began with the decision of the Clinton Administration to cooperate with the OECD's harmful tax competition initiative from 1998 onward." Focused on concerted action, the "Age of Cooperation" would promise "a way out from the need to balance U.S. international tax policy goals with competitiveness considerations."[61]

Competition in the market incentivizes companies to reduce their prices and increase the quality of their products and services. The belief that consumers are benefited by the healthy competition between companies lies at the very core of liberal capitalism. For this reason, States have intensively combated behaviors and structures that harm competition in the market, by means of strong antitrust legislation.[62]

However, globalization has also increased the competition among States, which have also been affected by the mobility of capital.[63] While companies compete essentially for consumers, States compete for productive resources (such as investments and qualified labor), for intangible capital and tax revenues. Among other attributes, the tax system is a relevant instrument available to States in their competition with the others.[64]

The consensus concerning the benefits of a free market for consumers is not reproduced with regard to State competition. Public finance debates bring two contrasting positions,[65] whose first arguments where developed in the context of discussions regarding the U.S. federalism.[66]

Following the Organisation for Economic Co-operation and Development's (OECD's) 1998 Harmful Tax Competition Report,[67] Avi-Yonah sees an age marked "by

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60. The most comprehensive list of inversions we are aware is credited to Professor Mihir Desai, including approximately 75 inverted companies. *See* C. Hwang. "The New Corporate Migration: Tax Diversion through Inversion," 80 *Brooklyn Law Review* 3 (2015), pp. 807–856.
61. R. S. Avi-Yonah. "All of a Piece of Throughout: the four ages of U.S. international taxation," 25 *Virginia Tax Review* 313 (2005), p. 334.
62. *See* R. A. Galendi Jr., Fundamentos da Tributação de Lucros no Exterior: entre competitividade e harmonização, 33 *Direito Tributário Atual* (2015), pp. 389–412.
63. *See* L. E. Schoueri. Globalização, investimentos e tributação: desafios da concorrência internacional ao sistema tributário brasileiro, 113 *Revista Brasileira de Comércio Exterior* (2012), pp. 6–13.
64. E. Toder. "International Competitiveness: Who Competes against Whom, and for What?," 65 *Tax Law Review* (2012), p. 509.
65. *See* W. Oates and R. Schwab. "Economic Competition Among Jurisdictions: efficiency enhancing or distortion inducing?," 35 *Journal of Public Economics* (1988), pp. 333–354.
66. *See* ACIR (Advisory Commission on Intergovernmental Relations), *Regional Growth: interstate tax competition*, (Washington: Comission Report, 1981).
67. Cf. OECD. *Harmful tax competition*, Paris: OECD, 1998.





a different response to globalization than unilateral competition."[68] Cooperation is seen as a way out from competition: in a cooperative scenario tax policy objectives of a State are no longer subject to competitive pressures and the State is finally free to tax as it pleases.

According to Charles Tiebout, competition would make States more efficient and sensible to the needs and desires of their citizens.[69] Scholars who see the State as a (leviathanic) revenue maximizer organism share this perception.[70] For these authors, competition among jurisdictions would be a powerful formula to combat undesired expansionist tendencies of the public sector over the private sector.[71] In this view, competition would have the welfare-generating function of disciplining the public sector, which is in a constant movement towards expansion.[72] Stigler has argued that competition would not present obstacles, but opportunities for communities to choose the type and scale of the functions of the Government they desire. In Tiebout's model, competition among a relatively high number of jurisdictions, each offering a different combination between taxation and public expenses, along with free flow of citizens, would be capable of granting efficiency gains, thus maximizing social welfare.[73]

For other scholars, however, jurisdiction competition would be a form of distorting public choice.[74] Accordingly, when seeking to attract industries and jobs, States would restrict taxation of companies to levels which are below the necessary for the provision of public services.[75] In 1980, the perspective of a "cut-throat competition" among federal states in the U.S. led to the suggestion of a federal intervention to save states from themselves.[76] Under this perspective, it is assumed that, given the specific nature of public goods, competition among States would lead to a "race to the bottom," of an eminently destructive character, which would subject States to a situation where they would not cooperate, even knowing that cooperation would be more beneficial than competition. In the case of tax competition, even if it would be better for States to maintain taxation levels, they would choose not to do so, fearing that other States would adopt tax incentives to attract investments. Those who share this perspective

68. R. S. Avi-Yonah. "All of a Piece of Throughout: the four ages of U.S. international taxation," 25 *Virginia Tax Review* 313 (2005), p. 334.
69. *See* C. Tiebout, "A pure theory of local expenditures," *The Journal of Political Economy*, 64, no. 5, (1956), pp. 416–424.
70. *See* G. Brennan and J. Buchanan *The Power to Tax: analytical foundations of a fiscal constitution*, (Indianapolis, Liberty Fund, 2000), p. 46.
71. *See* G. Brennan and J. Buchanan *The Power to Tax: analytical foundations of a fiscal constitution*, (Indianapolis, Liberty Fund, 2000), p. 200.
72. *See* W. Oates and R. Schwab. "Economic Competition Among Jurisdictions: efficiency enhancing or distortion inducing?," 35 *Journal of Public Economics* (1988), p. 334.
73. *See* C. Tiebout, "A pure theory of local expenditures," *The Journal of Political Economy*, 64, no. 5 (1956), pp. 416–424.
74. *See* G. Brennan and J. Buchanan *The Power to Tax: analytical foundations of a fiscal constitution*, (Indianapolis, Liberty Fund, 2000), p. 200 and ss. Compare with: W. Oates and R. Schwab. "Economic Competition Among Jurisdictions: efficiency enhancing or distortion inducing?," 35 *Journal of Public Economics* (1988), p. 342.
75. *See* W. Oates and R. Schwab. "Economic Competition Among Jurisdictions: efficiency enhancing or distortion inducing?," 35 *Journal of Public Economics* (1988), p. 335.
76. *See* ACIR (Advisory Commission on Intergovernmental Relations), *Regional Growth: interstate tax competition*, (Washington: Comission Report, 1981), p. 10.

argue that States should sign agreements granting minimal standards of State action, which, if signed between private companies would certainly be subject to antitrust sanctions.[77]

Even if prevailing, the argument that competition among States would necessarily imply distortions is not convincing. If residents of a State are actually concerned with the effect of tax competition over public services, then tax competition entails real burdens over citizens. It is not clear the extent to which citizens would tolerate and endorse a competitive behavior of the State, in the detriment of efficient public services provision. Tax competition promotes the diversity of Governments and tax systems, increasing local efficiencies.[78] In summary, the opposition to tax competition relies on two main economic arguments: (i) allowing tax competition would generate few efficiency gains; and (ii) such efficiency gains would not overcome the social loss arising from the decreasing of tax collection.[79]

As from the Harmful Tax Competition report,[80] tax competition between States has been put into perspective. The scope of this report is the behavior of jurisdictions which, by means of low taxation of mobile activities, distort the "actual" flow of investments, reduces the integrity of tax structures and transfer the tax burden to less mobile elements, such as labor.[81] This report was the first step towards more comprehensive harmonization measures such as those brought by the BEPS Project.

The Action Plan argues that "taxation is at the core of countries' sovereignty, but the interaction of domestic tax rules in some cases leads to gaps and frictions."[82] Such gaps would consist on the non-taxation of profits where "value is created." The BEPS Project, then, through coordinated measures, is intended to "realign" taxation with value creation.[83] The expression "realigning" is very interesting, because it implies that taxation has once been "aligned" with value creation.

Thus, the BEPS rhetoric is often structured as follows: (i) international taxation used to be aligned with value creation; (ii) subsequent events, mostly attributable to globalization, have distorted international taxation; (iii) in order to "realign" taxation with value creation, States must cooperate, and apply the measures suggested by the BEPS Project. For instance, as argued in the Final Report on Action 6, if the measures

77. *See* J. Roin. "Competition and Evasion: Another Perspective on International Tax Competition," 89 *The Georgetown Law Journal* (2000), p. 546.
78. *See* J. Roin. "Competition and Evasion: Another Perspective on International Tax Competition," 89 *The Georgetown Law Journal* (2000), p. 553.
79. *See* R. S. Avi-Yonah. "Globalization, Tax Competition, and the Fiscal Crisis of the Welfare State," 113 *Harvard Law Review* 7 (2000), pp. 1644–1647. This position is also held by the International Monetary Fund ("IMF"), which deems tax incentives as largely inefficient (*See* J. Stotsky, "Summary of IMF Tax Policy Advice," in *Tax Policy Handbook* (Washington: FMI, 1995), pp. 279–283). For a similar position, *see* Y. Brauner, "The Future of Tax Incentives for Developing Countries," *in* Y. Brauner, M. Stewart. *Tax, Law and Development* (Edward Elgar Publishing, Massachusetts, 2013) pp. 25–56.
80. *See* OECD. *Harmful tax competition*, Paris: OECD, 1998.
81. *See* OECD, *Harmful tax competition*, *supra*., p. 16.
82. OCDE (2013), Action Plan on Base Erosion and Profit Shifting, OECD Publishing, available at http://dx.doi.org/10.1787/9789264202719-en, access on July 22, 2016.
83. "Realigning taxation with economic activities and value creation" is a recurrent expression in many of the BEPS documents.





regarding the prevention of granting of treaty benefits in inappropriate circumstances are applied, "it is expected that profits will be reported where the economic activities that generate them are carried out and where value is created."[84] This reasoning grants that further discussion on inter-nations equity is avoided.

Curiously enough, the measures suggested are mostly intended to amplify taxing rights in the State of residence. Despite the consolidated interpretation of the arm's length standard set forth in Article 9 of the OECD-MC, by means of an aggressive interpretation, the BEPS Project intends to shift the provision to a "value creation" paradigm, which is not necessarily compatible with the arm's length as agreed by the Contracting States in several tax treaties[85] or with the jurisprudence of the European Court of Justice.[86] The outcome of this new interpretation is shifting taxation to capital exporting countries, which are, as per the BEPS Project reasoning, often the countries where value is created.[87]

Value creation, as per the BEPS Project, is attributed to "assets used, risks assumed and functions performed." This mantra is far from being able to determine in any and every case where value is created and works rather as a formula to deny the importance of demand (market) for value creation even though, as mentioned above, taxation where consumption occurs was the very reason for the whole BEPS movement. As a consequence, as "economic allegiance" and "neutrality," "value creation" is nothing more than a narrow view of the justifications for allocating tax jurisdiction, intended to amplify the taxing rights of the State of residence.

Some scholars intend to take one step further. In another text, Professor Avi-Yonah points out there would be a natural convergence of income tax rates among States, mostly due to tax competition. In his understanding, the BEPS Project would present "a chance to go further."[88] After considering that the European Union (EU) has never succeeded in coordinating tax rates, due to the diversity among its members (a factor which would also be present among the OECD and UN members), he poses that the G20 would present a different opportunity.[89] Unlike the other organizations, the G20 is composed of great capital exporters, which are residence to 90% of world's multinational enterprises. Hence, G20 members could commit to taxing their multinationals in a worldwide basis at a rate between 20% and 30%. In this case, no member

84. OECD (2015), Preventing the Granting of Treaty Benefits in Inappropriate Circumstances, Action 6 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project, OECD Publishing, Paris, p. 3, available at http://dx.doi.org/10.1787/9789264241695-en, access on July 22, 2016.
85. *See* L.E. Schoueri, "Arm's Length: Beyond the Guidelines of the OECD," 69 *Bulletin for International Taxation* 12 (2015), pp. 690–716.
86. *See* W. Schön, "Transfer Pricing Issues of BEPS in the Light of EU Law," 3 *British Tax Review* (2015).
87. For examples on these outcomes, *see* L.E. Schoueri, "Arm's Length: Beyond the Guidelines of the OECD," 69 *Bulletin for International Taxation* 12 (2015), pp. 690–716.
88. *See* R. S. Avi-Yonah. "Is it Time to Coordinate Corporate Tax Rates? A Note on Horst," *Public Law and Legal Theory Research Paper* Series, Paper No. 382 (2014), p. 2. The author argues that "*multinationals compete with each other across national borders, and no country wishes to put its multinationals at a competitive disadvantage. Because of this, corporate tax rates tend to move in unison.*"
89. A primitive version of these ideas where already present in his seminal article AVI-YONAH, "Globalization, tax competition...," *supra*., p. 1610.



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CHAPTER 7

# Taxing the Consumption of Digital Goods

*Aleksandra Bal*

## §7.01 INTRODUCTION

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A major characteristic of the modern economy is its shift to the intangible. Dematerialized content has become a major source of economic value, transforming the way companies are organized and transactions carried out. Last century witnessed the emergence of new business models and markets centred around the concept of digital goods.

In simple terms, digital goods are goods that can be fully expressed in electronic format so that their creation, transfer and consumption can be executed based on an electronic infrastructure such as the Internet.[1] They possess some characteristics that distinguish them from traditional physical goods. They are indestructible, easily transmutable and cheaply reproducible. The majority of them are experience goods, meaning that their quality can be evaluated only after usage.

Digital goods have placed strains on consumption taxes throughout the world. The evolution of technology has dramatically increased the ability of private consumers to shop online and the ability of businesses to sell to consumers around the world without the need to be present physically in the consumer's country. As consumption taxes were conceived at the time when commerce meant local traders selling products to consumers in their brick-and-mortar shops, technological advances and the proliferation of digital goods have made it necessary to revisit the existing rules.

1. C. Loebbecke, *Digital Goods: An Economic Perspecitve,* available at: *http://www.mtm.uni-koeln.de/team-loebbecke-publications-book-chapters/Chapt-024-2002-%20Digital%20Goods%20An%20Economic%20Perspective-scan.pdf*; S. Choi, D. Stahl & A. Whinston, *The Economics of Electronic Commerce*, ch. 2 (Macmillan Technical Publishing 1997); T. Rayna, *Understanding the Challenges of the Digital Economy: The Nature of Digital Goods*, available at: http://comstrat.org/fic/revue_telech/816/CS71_RAYNA.pdf.

Digital goods were the subject of many initiatives undertaken at both international and national levels in the last few years. The international debate in respect of taxation issues arising from electronic commerce was largely driven by the Organisation for Economic Co-operation and Development (OECD's) Committee on Fiscal Affairs (CFA). OECD's first major policy document was the framework for the taxation of electronic commerce, which was presented at the Ottawa conference in October 1998.[2] The framework was followed by several implementing guidelines.[3] More recently, OECD recognized jurisdictional challenges of the digital economy in its Base Erosion and Profit Shifting (BEPS) initiative.[4] BEPS Action 1 called upon the examination of 'the application of source rules, and how to ensure the effective collection of VAT/GST with respect to the cross-border supply of digital goods and services'.[5] The Consolidated Value Added Tax / Goods and Services Tax (VAT/GST) Guidelines, adopted by the OECD member countries in November 2015, set the international standard for the VAT treatment of cross-border transactions in intangibles by making recommendations regarding their place of supply[6] and collection mechanisms.[7] OECD recommended that where it is not necessary for the supplier and customer to be in the

2. OECD, *A Borderless World: Realizing the Potential of Global Electronic Commerce* (OECD 1998). The Ottawa Report (1998) concluded that the same principles that governments apply to the taxation of conventional commerce should apply to electronic commerce. These principles included the well-known tax policy concepts of neutrality, efficiency, certainty, simplicity, effectiveness, fairness and flexibility. New legislative measures were not precluded, provided that they were intended to assist in the application of the existing taxation principles and not to impose a discriminatory tax treatment of electronic commerce transactions. The Ottawa Report (1998) recommended treating the supply of digitized products as a supply of services and to tax it in the country of consumption. International consensus had to be sought on the circumstances under which supplies were held to be consumed in a jurisdiction. Countries were advised to examine the use of reverse charge mechanism, self-assessment or other equivalent mechanisms for digital supplies acquired from suppliers outside the country.
3. OECD, *Report by the Consumption Tax Technical Advisory Group* (OECD 2000); OECD, *Report by the Technology Technical Advisory Group* (OECD 2000); OECD, *Taxation and Electronic Commerce: Implementation the Ottawa Taxation Framework Conditions* (OECD 2001); OECD, *Consumption Tax Aspects of Electronic Commerce* (OECD 2001).
4. OECD, *Action Plan on Base Erosion and Profit Shifting* (OECD 2013). The fundamental idea behind the BEPS project was concerns about multinational enterprises (MNEs) being able to avoid tax by artificially separating income from activities that generate it. The BEPS Action Plan set out 15 Actions to counteract commonly employed BEPS strategies and designated tax challenges of the digital economy as Action 1. On 24 March 2014, the OECD published a discussion draft on Action 1 and on 16 September 2014 the final report was released.
5. OECD, *Addressing the Tax Challenges of the Digital Economy. Action 1: 2014 Deliverable* (2014), available at: www.oecd.org/tax/addressing-the-tax-challenges-of-the-digital-economy-97892642 18789-en.htm.
6. The terms 'place of supply' and 'place of taxation' are often used interchangeably. However, in some tax systems (e.g., in New Zealand), determining the place of supply is the first step in determining the place of taxation. The place of supply determines which jurisdiction has the right to tax, whereas the place of taxation is the country where the tax is levied. In the European Union, a two-step approach is applied to the supply of goods: in the case of exports, the exporting country is the place of supply but the place of taxation is somewhere else since in the exporting country the supply is zero rated. For services, a one-step approach applies, i.e., the place of supply is equivalent to the place of taxation. *See* A. Cockfield et al., *Taxing Global Digital Commerce* p. 244 (Kluwer 2013).
7. OECD, *International VAT/GST Guidelines* (OECD 2015).





same location when the services are supplied, the jurisdiction in which the customer has his usual residence should have taxing rights. In order to collect GST on these supplies, non-resident suppliers should be required to register and file GST returns in the jurisdiction of the consumer's usual residence. The OECD's approach has been followed by many jurisdictions, such as Member States of the European Union (EU),[8] Norway, South Korea, Japan, Switzerland, South Africa and New Zealand. Australia is currently in the process of introducing similar rules.

The aim of this chapter is to investigate the concept of digital goods and to examine what can be interfered about the taxation of digital goods from the concept of sovereignty.[9] Section §7.02 provides the necessary context and briefly discusses the rules applicable to the taxation of digital goods in the EU, Australia and New Zealand. Section §7.03 proceeds with a more detailed examination of the concept of digital goods. Section §7.04 defines the concept of sovereignty and examines how it is affected by supplies of digital goods. The final section concludes.

## §7.02 LEGAL FRAMEWORK

### [A] European Union

EU VAT is levied on supplies of goods and services by a taxable person acting as such. A supply of goods is defined as the transfer of the right to dispose of tangible property as owner.[10] A supply of services is defined residually as any transaction which is not a supply of goods.[11] An important category of services are electronically supplied services (commonly referred to as 'digital supplies' or 'online services'). They are defined as services delivered over the Internet or an electronic network, the nature of which renders their supply essentially automated, involving minimum human intervention and impossible in the absence of information technology.[12]

8. The European Union was the pioneer of adopting the destination-based taxation of business-to-consumer supplies of services and introducing simplified registration mechanisms. Originally, many supplies of services were subject to VAT at origin, i.e., in the Member State where the service provider was established. This was a logical solution at the time when most services were provided domestically. Due to the rapid increase in the volume of cross-border services, it was recognized that the origin-based approach distorted competition in favour of business activity in low-tax countries. To increase the application of the destination principle, the European Union introduced a major amendment to the place-of-supply rules in 2008 (Council Directive 2008/8/EC of 12 February 2008 amending Directive 2006/112/EC as regards the place of supply of services, OJ L 44 (2008)). This reform, commonly referred to as the 'VAT Package', implemented changes to the rules on the place of taxation of services over the period 2010–2015.
9. This chapter focuses on the taxation of business-to-consumer (B2C) supplies as business-to-business (B2B) supplies do not involve final consumption. Since only private individuals are capable of having a personal sphere, only they can be engaged in consumption. Businesses do not have personal needs; they purchase and use goods but do not consume them.
10. Article 14(1) Council Directive 2006/112/EC of 28 November 2006 on the common system of value added tax, OJ L347/1 (2006) (hereinafter referred to as the VAT Directive (2006/112).
11. Article 24 VAT Directive (2006/112).
12. Article 7(1) VAT Implementing Regulation (282/2011).



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Under the place-of-supply rules applicable as from 1 January 2015, all supplies of electronic services are subject to the VAT rules of the country of the customer.[13] In order to establish who has to account for the VAT due, in EU scenarios, it is necessary to distinguish between business-to-business (B2B) and business-to-consumer (B2C) transactions. In the EU, the supplier may regard his customer as a business (taxable person) if the customer has communicated his VAT identification number to him and the supplier has verified its validity or if the customer has demonstrated that he is in the process of registering for VAT.[14] If the customer is located outside the EU, his status is not relevant since the supply is outside the scope of EU VAT.

The reverse charge mechanism[15] applies to cross-border supplies to businesses (i.e., the VAT liability is shifted to the customer who accounts for VAT on the supply in his VAT return), whereas a simplified registration mechanism (One Stop Shop (OSS)/Mini One Stop Shop (MOSS) scheme) may be used in respect of cross-border supplies of electronic services to EU final consumers. In the latter case, since the reverse charge cannot be applied, the supplier must determine where his customers are established, have a permanent address or usually reside in order to apply the correct VAT rate.[16] To assist suppliers with the identification of the location of their non-taxable customer, the Commission has issued a detailed regulatory framework consisting of the VAT Implementing Regulation (282/2011), which establishes a number of

13. Article 44 VAT Directive (2006/112) (the default place-of-supply rule for B2B services), Arts 58 and 59 VAT Directive (2006/112) (for supplies to non-taxable persons). However, under Art. 59a of the VAT Directive (2006/112), Member States may exercise the option of levying VAT where consumption actually occurs. A 'use and enjoyment' clause may be applied by Member States to electronic services supplied by EU suppliers to both private and business customers. It allows Member States to consider that services supplied within their territory or in third countries are supplied, respectively, outside the European Union or within their territory if this is where those services are effectively used and enjoyed.
14. Article 18(1) Council Implementing Regulation 282/2011 of 15 March 2011 laying down implementing measures for Directive 2006/112/EC on the common system of value added tax, OJ L77/1 (2011), as amended by Council Implementing Regulation (EU) 1042/2013 of 7 October 2013 amending Implementing Regulation (EU) 282/2011 as regards the place of supply of services, OJ L284 (2013). The amended version of the Council Implementing Regulation 282/2011 is hereinafter referred to as the VAT Implementing Regulation (282/2011).

    According to Art. 18(2) of the VAT Implementing Regulation (282/2011), if no VAT identification number has been communicated, the supplier *may* regard his customer as a non-taxable person, irrespective of any information to the contrary. The purpose of this provision is to provide certainty for the supplier as to the status of the customer by disregarding information other than the VAT identification number. The use of 'may' makes it optional for the supplier to use this provision. If the supplier does not know the VAT identification number of the customer but has other evidence to substantiate his status as a taxable person, the supplier may issue an invoice without VAT and apply the reverse charge mechanism. In such a scenario, he assumes the risk for the incorrect status determination and will be held liable for VAT payment if his determination turns out to be wrong.
15. Article 196 VAT Directive (2006/112).
16. The term 'established' refers to non-registered legal persons and the terms 'permanent address' and 'usual residence' refer to non-taxable natural persons. A permanent address of a natural person is the address entered in the population or similar register, or the address indicated by that person to the relevant tax authorities, unless there is evidence that this address does not reflect reality. The place where a natural person usually resides is the place where that natural person usually lives as a result of personal and occupational ties. Where the occupational ties are in a country different from that of the personal ties, or where no occupational ties exist, the place





rebuttable presumptions and an evidence rule, supplemented by more detailed explanations in the non-binding Explanatory Notes.[17] Under the presumptions laid down in the VAT Implementing Regulation (282/2011), electronic services that are provided at, for example, a Wi-Fi hot spot, an Internet café, a restaurant or a hotel lobby, are presumed to be supplied at those places.[18] Also, non-taxable persons are presumed to be established or resident at the place of installation of the fixed landline through which they receive the services or in the country whose code is mentioned on the SIM card when they receive the services through a mobile network.[19] According to the evidence rule, it is assumed that the customer is established at the place identified on the basis of two items of non-contradictory evidence (e.g., billing address, bank details, IP address or other commercially relevant information).[20]

The OSS scheme was introduced on 1 July 2003 to avoid a situation in which, for the purpose of having to account for VAT on B2C electronic services in a maximum of twenty-eight Member States, non-EU suppliers must be registered in all of those Member States. Under this scheme, the non-EU supplier can register and account for VAT in a single Member State, but applies the VAT rate of the customer's Member State.[21] EU suppliers of electronic services to EU final consumers have the option to use a similar arrangement (the MOSS), i.e., to register and remit VAT only in the Member State of their establishment. The MOSS regime is optional; however, a taxable person that chooses to use the scheme must apply it in all relevant Member States. The scheme cannot be applied to supplies of electronic services in the Member State where the taxable person is established; such supplies must be declared in the domestic VAT return.

In certain circumstances, responsibility for the collection and remittance of VAT on supplies of electronic services may be shifted from the supplier to the operator. Article 9a(1) of the VAT Implementing Regulation (282/2011) introduces a rebuttable presumption that a taxable person who takes part in the supply of electronic services is acting in his own name but on behalf of the provider of those services. This means that the intermediary party is deemed to act as a 'commissionaire', i.e., to have received and supplied the services itself.[22] The presumption does not apply to taxable persons who solely provide payment-processing services (e.g., credit card companies).[23] Shifting the responsibility for VAT liability to platform operators and

of usual residence shall be determined by personal ties that show close links between the natural person and a place where he is living (Arts 12 and 13 VAT Implementing Regulation (282/2011)).

17. *See* European Commission, *Explanatory Notes on the EU VAT Changes to the Place of Supply of Telecommunications, Broadcasting and Electronic Services That Enter into Force in 2015* (3 April 2014).
18. Article 24a VAT Implementing Regulation (282/2011).
19. Article 24b VAT Implementing Regulation (282/2011).
20. Article 24d and 24f VAT Implementing Regulation (282/2011).
21. The One Stop Shop Scheme cannot be used by non-EU suppliers that are already registered in the European Union (e.g., because they receive services that are effectively used and enjoyed in a Member State or perform intra-Community supplies of goods). *See* Art. 358a VAT Directive (2006/112).
22. For commissionaire arrangements, *see* Art. 28 VAT Directive (2006/112).
23. Article 9a(3) VAT Implementing Regulation (282/2011).



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distributors is aimed at minimizing compliance costs. Platform operators typically have greater knowledge about their customer base, are larger in scale and generally are better able to comply with regulatory requirements in the countries in which their distribution services are available than providers of electronic content that is distributed via online platforms.

### [B] Australia

Australian GST law does not adopt the usual practice of dividing taxable supplies into supplies of goods and services. A supply is defined to mean 'any form of supply whatsoever'.[24] The objects of supplies are referred to as things.[25] For cross-border purposes, things are divided into 'goods', 'real property' and everything else. To determine the place of taxation, it first needs to be considered whether a supply is 'connected with Australia'.[26] If a supply is connected with Australia, the place of taxation can still be abroad due to the application of the rules on GST-free exports and consumption outside Australia. For supplies not connected with Australia, the supply will still be taxed in Australia if it is considered an inbound service or importation of goods.

Under current Australian law, things (which are not goods or real property) imported by Australian consumers are not subject to Australian GST. Thus, the consumption of digital products provided by non-resident suppliers is not currently caught by the GST rules. This results in forgone GST revenue and places domestic businesses, which generally have to charge and remit GST on digital products and services they provide to Australian consumers, at a tax disadvantage compared to overseas businesses.

In the 2015–2016 Budget, the Government announced that it would extend GST to cross-border supplies of digital products and other services imported by consumers with effect from 1 July 2017 (the proposal was frequently referred to as a 'Netflix tax' as it was made after Netflix started providing services to Australian consumers without charging GST).[27] Legislation giving effect to this measure (Tax and Superannuation Laws Amendment (2016 Measures No. 1) Act 2016) received Royal Assent on 5 May 2016. The amendments to the Australian law are broadly modelled on similar rules currently in operation in the EU.

Under the new law, overseas companies selling digital products and other services will be required to register, collect and remit GST on their sales to Australian

24. Section 9-10(1) GST Act 1999.
25. A 'thing' is defined as 'anything that can be supplies or imported'. Section 195-1 GST Act 1999.
26. Where the term 'Australia' is used, it refers to the 'indirect tax zone' as defined in section 195-1 of the GST Act 1999. With effect from 1 July 2015, the term 'Australia' has been replaced in nearly all instances within the GST legislation with the term 'indirect tax zone'. The change has been made by the Treasury Legislation Amendment (Repeal Day) Act 2015. 'Indirect tax zone' means Australia, but does not include external territories and certain offshore areas.
27. http://www.budget.gov.au/2015-16/content/bp2/download/BP2_consolidated.pdf.





consumers. GST will not only be imposed on inbound intangible consumer supplies,[28] such as digital content, games and software, but will also extend to consultancy and professional services performed offshore for customers in Australia. Overseas entities will be able to elect to have limited registration for GST purposes without being able to access input tax credits. Only supplies made to consumers will be caught: B2B transactions will not be affected by the new rules. The new law requires suppliers to take reasonable steps to ascertain whether the recipients of their supplies are Australian consumers. After taking those steps, the suppliers must reasonably believe that their customers are Australian customers. The new law recognizes that a supplier should be able to rely on its existing business systems and processes for forming this conclusion.

In some circumstances, responsibility for GST liability that arises under the new law may be shifted from the supplier to the operator of an electronic distribution service for services provided through the electronic distribution service he operates. This may happen if the operator controls any of the key elements of the supply, such as delivery, charging or terms and conditions. As a result of being treated as making the supply, the operator will be liable for the GST on the supply and the supply will be included in his GST turnover for all purposes, including whether they are required to be registered for GST.

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### [C] New Zealand

In New Zealand, supplies of goods and services as well as importation are subject to GST.[29] The concept of goods includes both tangible and intangible property as it is defined to mean 'all kinds of personal and real property' except money and choses in action. Services are defined by reference to what is not goods.[30] To determine the place of taxation, New Zealand applies different rules for resident and non-resident suppliers. All supplies by residents are considered to take place in New Zealand but the zero-rating rules are used to remove outbound and foreign supplies from the tax net. In contrast, supplies by non-residents are considered to take place outside New Zealand and the reverse charge mechanism for imported services is used to ensure that services consumed within New Zealand are subject to tax there. Until 1 October 2016, digital services provided by non-residents to New Zealand consumers were not subject to tax in New Zealand.

As from 1 October 2016, offshore suppliers providing cross-border remote services to New Zealand resident consumers are required to register and charge GST on those supplies.[31] The non-resident supplier must treat a customer as a New Zealand resident on the basis of two non-conflicting pieces of evidence that support the

28. A supply is an inbound intangible consumer supply if it is a supply of anything other than goods or real property that is not done wholly in the indirect tax zone or made through an enterprise the supplier carries on in the indirect tax zone.
29. Section 8(1) and 12(1) GST Act 1985.
30. Section 2(1) GST Act 1985.
31. Taxation (Residential Land Withholding Tax, GST on Online Services, and Student Loans) Act 2016.

conclusion the person is resident in New Zealand.[32] Non-resident suppliers are required to register and file GST returns when their supplies of remote services to New Zealand consumers exceed NZD 60,000 in a twelve-month period. Supplies to New Zealand GST-registered businesses only count towards this threshold if the parties agree that the supply is zero-rated. A simplified 'pay-only' registration system has been made available to offshore suppliers who are only required to return GST and who do not have any New Zealand GST costs to claim back. When certain conditions are satisfied, operators of electronic marketplaces (such as an app store) are required to register and return GST on supplies made through the marketplace instead of the underlying supplier.

## §7.03 THE CONCEPT OF DIGITAL GOODS

### [A] Introductory Remarks

The key feature of the digital economy is the digitalization of previously existing goods and the development of new purely digital goods. Digital goods are intangible goods that are stored, delivered and used in electronic format. They are delivered to customers through e-mail or downloaded from the Internet.

There is a large body of literature on the taxation of the digital economy and electronic commerce, evaluating different national and international approaches and searching for best practices.[33] However, hardly any publication provides a detailed examination of the characteristics of digital goods. Since sound policy rules can be developed once the underlying phenomenon is properly understood, this section discusses the concept of digital goods and its use for consumption tax purposes in the EU, Australia and New Zealand.

### [B] General Definition

The main characteristics of digital goods are indestructibility, easy reproducibility and transmutability.[34] Digital goods are indestructible, i.e., they are not subject to wearing

32. The items of evidence include: the person's billing address; the internet protocol (IP) address of the device used by the person or another geo-location method; the person's bank details, including the account the person uses for payment or the billing address held by the bank; the mobile country code (MCC) of the international mobile subscriber identity (IMSI) stored on the subscriber identity module (SIM) card used by the person; the location of the person's fixed landline through which the service is supplied to them; and other commercially relevant information.
33. For example, R.L. Doernberg et al., *Electronic Commerce and Multijurisdictional Taxation* (Kluwer Law International 2001); B. Westberg, *Cross-border Taxation of E-commerce* (IBFD 2002); R.L. Doernberg & L. Hinnekens, *Electronic Commerce and International Taxation* (Kluwer Law International 1999); S. Basu, *Global Perspectives on E-commerce Taxation Law* (Aldershot Ashgate 2007); R.A. Westin, *International Taxation of Electronic Commerce* (Kluwer Law International 2007); A. Cockfield et al., *Taxing Global Digital Commerce* (Kluwer 2013).
34. This section is based on Loebbecke, *supra* n. 1; Choi, *supra* n. 1 and Rayna, *supra* n. 1.





out from usage. The quality of a digital product does not degrade no matter how long or how often it is used. Although the media used to store and distribute digital goods are prone to failure and have a finite life expectancy, digital goods can last forever. Although the creation of digital goods may require high fixed costs, they can be subsequently replicated at no cost and transferred without delay to almost everywhere. Transmutability means that the content of digital products can be changed instantly. Such goods can be customized and manipulated more easily than physical goods. Given the high degree of customizability, consumers are frequently involved in the production of digital goods, for example, by making decisions about the content, mode of display or transformation.

Digital goods are frequently classified as public goods. Public goods share two important properties: they are both non-rival in consumption and non-excludable in usage. A good is non-rival in consumption if the consumption activity of each person does not decrease the quantity of good available in the economy. As digital goods can be copied without any loss of quality at very low costs, the consumption activity of one consumer does not decrease the potential consumption of other consumers. A good is non-excludable if no one can be prevented from consuming it. Although producers of digital goods initially have the ability to directly exclude certain consumers (e.g. by preventing downloads if people do not pay) and enforce copyright by legal means, it proves to be more and more difficult to prevent unauthorized persons from using digital products. Anybody owning a digital good becomes a potential supplier of this good. As the number of people owning the good grows, the number of consumers able to obtain the good from other consumers rather than from the producer rises.

Based on the customer's ability to judge the value of a product, goods are divided into search and experience goods. The quality of search goods can be determined without actually using them. In contrast, the value of experience goods cannot be determined prior to purchase. The fact that digital goods are experience goods is related to their content. Although consumers can acquire sufficient information on the technical characteristics of digital goods without experiencing them, the value obtained from these attributes remains unknown or uncertain. Moreover, the value of the content of some digital goods is so subjective that it is impossible for consumers to obtain full information on the goods without experiencing them.

Based on the characteristics, the following conclusions can be drawn:

- since digital goods are indestructible, they can be consumed multiple times ('unlimited consumption');
- since digital goods are easily transferable and movable, consumption follows the consumer who can use them anywhere ('multiple destination');
- digital goods can be re-produced and sold by consumers whose activity of reproducing and distributing digital goods may easily qualify as an entrepreneurial one.



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### [C] Definition for Indirect Tax Purposes

The OECD VAT/GST Guidelines do not explicitly mention digital goods but apply a broad definition of internationally traded services and intangibles. They define a supply of services or intangibles as a supply where one party does something for, or gives something (other than something tangible) to, another party or refrains from doing something for another party, for consideration.[35] The previous OECD reports also focused on a broad category of cross-border supplies of services and intangible property capable of delivery from a remote location.[36]

Some countries follow the OECD approach and do not provide for detailed definitions of digital goods. In New Zealand, a broad definition of remote services is used for the purposes of taxing supplies made by overseas businesses to New Zealand consumers. A remote service is defined as a 'service where, at the time of the performance of the service, there is no necessary connection between the physical location of the recipient and the place of physical performance.' Non-digital services, such as consulting, accounting and legal services, can also be supplied as remote services. Australia does not distinguish a separate category of digital goods (or electronic services) either but applies uniform rules to all inbound intangible consumer supplies, which are defined as supplies of anything other than goods or real property that are not done wholly in the indirect tax zone or made through an enterprise the supplier carries on in the indirect tax zone.

The EU took a different approach. Under EU VAT legislation, digital goods (called 'electronically supplied services' for VAT purposes) are a separate category of services. They are defined as services delivered over the Internet or an electronic network, the nature of which renders their supply essentially automated, involving minimum human intervention and impossible in the absence of information technology.[37] A non-exhaustive list of those services provided in the VAT Implementing Regulation (282/2011) includes, *inter alia*, the supply of digitized products (movies, music, games), services automatically generated from a computer via the Internet or an electronic network, in response to specific data input by the recipient, Internet Service Packages (ISP) of information in which the telecommunications component forms an ancillary and subordinate part, website hosting, remote systems administration, online data warehousing, accessing the digitized content of books and other electronic publications, the provision of advertising space, use of search engines and Internet directories and automated distance teaching (except where the Internet or similar electronic network is used as a tool simply for communication between the teacher and student).[38]

The correct classification of goods or services for EU VAT purposes is extremely important as it determines the applicable place-of-supply rules, VAT rates and exemptions. For example, the VAT Directive (2006/112) allows for the application of reduced

35. VAT/GST Guidelines, *supra* n. 7, at p. 27.
36. For example, OECD, *Consumption Tax Aspects of Electronic Commerce* p. 10 (OECD 2001).
37. Article 7(1) VAT Implementing Regulation (282/2011).
38. Article 7(2) and Annex 1 VAT Implementing Regulation (282/2011).





rates to 'books on all physical means of support'. However, books in a digitalized format cannot benefit from a reduced VAT rate as 'the reduced rates shall not apply to electronically supplied services'.[39]

The VAT treatment of books and e-books has been the subject of a lively debate in the EU. Despite the clear wording of the VAT Directive (2006/112), France and Luxembourg started applying the reduced rate to electronic books, giving publishers established in those countries an enormous commercial advantage over their competitors. This was so because, until 31 December 2014, supplies of electronic services to final consumers were governed by the VAT law of the country of the supplier. Both countries claimed that the electronic format was an alternative physical means of support and that a different treatment of books and e-books violated the principle of neutrality. The European Commission started an infringement procedure against both countries and the Court of Justice of the European Union (CJEU) ruled in favour of the Commission, stating that the supply of electronic books cannot be subject to the reduced rate.[40]

On 11 September 2014, the CJEU gave its decision in *K Oy* (Case C-219/13) regarding the question of whether or not reduced rates for printed books should also be applied to books published on another physical medium (i.e., books sold on CD-ROM or USB sticks).[41] The case was referred to the CJEU by the Finnish Supreme Administrative Court and the issue raised was whether this apparently different treatment of similar products complied with the principle of fiscal neutrality. The CJEU ruled that it is up to national courts to decide whether printed books and books on other physical mediums are sufficiently different from each other to justify the application of a reduced rate of VAT to one but not the other. National courts have to assess the issue from the point of view of an 'average consumer'. Thus, if a national court concludes that printed books and books on other means of support achieve substantially the same purpose from the perspective of an average consumer in that Member State, then the court will have no choice but to rule that the same VAT treatment must be applied to both.

In her decision of 8 September 2016,[42] in the *RPO* case (C-390/15), Advocate General Juliane Kokott concluded that the different treatment of digital publications and those supplied on physical means of support does not amount to an infringement of the principle of equal treatment. It is up to the EU legislature, not the Court of Justice, to assess whether these publications are in competition with each other.

Between July and September 2016, the European Commission held an open public consultation on the application of reduced VAT rates to electronically supplied

39. Article 98(2) VAT Directive (2006/112). It is interesting to observe that the European Union applies higher tax rates to digital goods than to their equivalent in printed form, whereas digital goods are treated more favourably than their printed counterparts in the United States (i.e., they are not subject to tax in many states and their inter-state supply escapes taxation if the seller lacks nexus in the state of the recipient).
40. CJEU, 5 March 2015, Case C-479/13, *European Commission v. French Republic* and CJEU, 5 March 2015, Case C-502/13, *European Commission v. Grand Duchy of Luxemburg*.
41. CJEU, 11 September 2014, Case C-219/13, *K Oy v. Veronsaajien oikeudenvalvontayksikkö, Valtiovarainministeriö*.
42. AG Opinion, 8 September 2016, Case C-390/15, *Rzecznik Praw Obywatelskich (RPO)*.



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publications. Some 858 stakeholders responded to the consultation, whereby 94% of the respondents agreed that Member States should be allowed to apply a reduced VAT rate to e-books and 88% of the respondents agreed that Member States should be allowed to apply a reduced VAT rate to e-newspapers and e-periodicals.[43] Following the view of the majority of the respondents, on 1 December 2016, the European Commission announced its intention to enable Member States to apply the same VAT rate to e-publications as that applicable for their printed equivalents, removing provisions that excluded e-publications from the favourable tax treatment allowed for traditional printed publications.

In this context, a question arises whether the application of a different rate to books and electronic books is in breach of the principle of VAT neutrality. Base on the CJEU case law, the principle of VAT neutrality prevents the application of a different VAT treatment to similar supplies or to non-similar supplies that are in competition with one another so that a different tax treatment would be likely to affect consumers' decisions.[44] As both print and e-books provide identical content, it would seem logical to allow both of them to benefit from the reduced rate. However, their functionalities may render them not similar products. E-books require a reader or a different electronic devise to access their content, they offer additional functionalities (search options, hyperlinks) and do not take any physical space. If based on their accessibility, storability and functionality, it is concluded that e-books are different from print books, it must be determined whether both types are offered in competition with one another. This must be assessed against the consumer's experience[45] and economic reality.[46] A survey conducted by PwC indicated that the driver for purchases of a book is its content and it is irrelevant whether the book is in a print or digital format.[47] It remains to be seen whether other research will confirm this conclusion.

43. European Commission, *Summary Report Responses received on The Commission's consultation on reduced VAT rates for electronically supplied publications* (October 2016), https://circabc.europa.eu/sd/a/64320cf4-021f-48e3-941b-b34224ec2290/Summary%20Report.pdf.
44. CJEU, 10 November 2011, Case C-259/10, *Commissioners for Her Majesty's Revenue and Customs v. The Rank Group PLC)*; CJEU, 19 July 2012, Case C-33/11, *A Oy*.
45. CJEU, 11 September 2014, Case C-219/13, *K Oy v. Veronsaajien oikeudenvalvontayksikkö, Valtiovarainministeriö*: 'To determine whether goods or services are similar, account must be taken primarily of the point of view of a typical consumer. Goods or services are similar where they have similar characteristics and meet the same needs from the point of view of consumers, the test being whether their use is comparable, and where the differences between them do not have a significant influence on the decision of the average consumer to use one or the other of those goods or services' and 'as the average consumer's assessment is liable to vary according to the different degree of penetration of new technologies in each national market and the degree of access to the technical equipment enabling the consumer to make use of books published on physical supports other than paper, it is the average consumer in each Member State who must be taken as a reference'.
46. CJEU, 23 April 2009, Case C-357/07, *The Queen on the application of TNT Post UK Ltd v. The Commissioners of Her Majesty's Revenue & Customs and Royal Mail Group Ltd*: 'the assessment of the comparability of the services supplied hinges not only on the comparison of individual services, but on the context in which those services are supplied'.
47. PwC, *Media Trend Outlook: E-books on the Rise* (May 2014).



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The EU definition is narrower than the OECD recommendations and does not cover several types of services that are capable of delivery from a remote location. Several components of the EU definition ('essentially automated' or 'minimum human intervention') are vague and may give rise to classification problems. By including the requirement of 'minimum human intervention', the provision of distance teaching (i.e., remote participation in live online classes) and computer repair services, both of which are made entirely via the Internet, do not qualify as electronically supplied services. This may create artificial and unnecessary distinctions among similar intangible products. Since the definition of digital goods is used in a cross-border context, it should not be difficult to interpret by non-resident suppliers who are not familiar with EU VAT legislation. Therefore, this chapter advocates the adoption of a broad and simple definition to capture all supplies of digital goods by non-residents. The OECD provided a good example of such as definition when it referred to 'services and intangible property capable of delivery from a remote location'.

## §7.04 DESIGN ISSUES AND SOVEREIGNTY

### [A] Concept of Sovereignty

Under the traditional view, states are entitled to self-determination in most regulatory matters. They are said to have supreme and exclusive rule over their own people within their territorial borders. With regard to taxation, this traditional view means that states have the right to decide through political means and democratic processes whether and how to tax an activity that occurs within their territories and people who are deemed to be their residents or citizens. Decisions about the tax system should be made by national governments independent of outside interference.[48]

However, in the twentieth century, sovereignty ceased to be equated with complete state autonomy in tax matters.[49] Sovereignty includes a responsibility to the international community and a duty to respect the sovereign right of other states. This shift in meaning occurred due to the work of the OECD to curb harmful tax competition. OECD believed that countries have a duty to comply with certain standards of transparency and information exchange and to abstain from providing facilities that permit tax evasion and encourage non-compliance with the tax laws of other countries. States cannot design their tax system as they please. The concept of sovereignty includes respect for sovereignty of other countries.

48. For the concept of sovereignty, *see* A. Christians, *Sovereignty, Taxation and Social Contract*, 18 Minn. J. Int'l L. 99 (2009); M. Graetz, *Taxing International Income: Inadequate Principles, Outdated Concepts, and Unsatisfactory Policies*, 54 Tax L. Rev. 261 (2001); P.B. Musgrave, *Sovereignty, Entitlement, and Cooperation in International Taxation*, 26 Brook. J. Int'l L. 1335 (2001); P. Genschel, *Globalization and the Transformation of the Tax State*, 13 Eur. Rev. 53 (2005).
49. Christians, *supra* n. 48, at p. 101.

### [B] Intra-jurisdictional Reach

Sovereignty implies that states must make decisions about their jurisdictional reach. Since people's activities overlap territorial boundaries, more than one state may have a legitimate claim to tax certain activities. For income tax purposes, the source of the income and the residence of the taxpayer are generally recognized as legitimate grounds for an assertion of jurisdiction to levy tax. In the context of consumption tax, the choice of jurisdiction to tax is governed by two principles: the principle of origin and the principle of destination.[50]

Under the origin principle, countries levy VAT on the value created within their own borders (i.e., exports are taxed on the same basis and at the same rate as local supplies and imports are exempt with the right to deduct input VAT). Where the value chain crosses several jurisdictions, the total amount of tax reflects the various rates applicable in countries where a value is added, clearly favouring production in low-tax jurisdictions.[51] A commonly made mistake is to confuse the origin principle with the supplier's location. Equating the origin of a supply with the place where the supplier is established would disregard the fact that certain supplies bear no relationship with the place where the supplier is established (e.g., supplies related to immovable property or supplies of transport services). Thus, the origin principle should be properly understood as ensuring that the country from which the supply is made has the right to assert jurisdiction to tax the supply.

Under the destination principle, the total tax paid in relation to a supply is determined by the rules applicable in the jurisdiction to which a supply is made and all revenue accrues to that country (i.e., exports are exempt with refund of input taxes, and imports are taxed on the same basis and with the same rates as local production). The key difference between both principles is that the destination principle ensures that all consumption within a particular jurisdiction is treated in the same way, whereas the origin principle makes sure that consumers from different jurisdictions are on an even footing.

From the point of view of formal sovereignty, there are no restrictions on the type of tax rules that states adopt. What is deemed appropriate changes over time through the acceptance of practices by some states. Currently, there is a widespread consensus that the destination principle is the proper way to tax international trade.[52] Since the object of VAT/GST is to tax consumption, the country where consumption takes place should have the right to assert jurisdiction to tax.

In theory, in a destination-based VAT system, the place-of-supply rules should identify the place of actual consumption. However, in most cases, the supplier is not able to identify such a place at the time of the supply since the person who will 'consume' the goods or services may not necessarily be the purchaser or at the time of

50. VAT/GST Guidelines, *supra* n. 7.
51. If all countries had identical VAT systems, the origin and destination principles would become equivalent.
52. VAT/GST Guidelines, *supra* n. 7, at p. 27; A. Schenk & O. Oldman, *Value Added Tax: A Comparative Approach* p. 35 (Cambridge University Press 2007).





the supply it may not be sure where the goods will actually be consumed. Consumption taxes are imposed as transaction taxes, meaning that the amount of tax must be determined as soon as the consumer makes the expenditure, irrespective of when and how the goods will be used later on. The term 'consumption' merely indicates who bears the tax burden. As the decision about the place of taxation must be made at the time of the transaction, all destination-based VAT systems use various proxies (e.g., the place where services are used and enjoyed, the permanent address or the usual residence of the customer) to predict with reasonable accuracy the place where goods and services are likely to be consumed.

In the context of digital goods, the application of the destination principle triggers two important questions: first, whether it is possible (at least in theory) to determine the destination of digital goods (i.e., the place where the consumption of digital goods occurs); and, second, what proxies can be used to identify that place.

Identifying the place where digital goods are actually consumed is not an easy task. Digital goods bear no relationship with a particular geographical location. They can be moved and consumed many times without delay or transport costs. The consumer can access them everywhere (although sometimes access to the Internet is necessary). Digital goods follow the consumer: he can use them both at the place of his usual residence and during his trips abroad. Since one single place of consumption of digital goods cannot be determined, the use of the traditional concepts of origin and destination seems to be questionable in the context of digital goods. If something can be consumed everywhere, it makes little sense to designate one of these multiple locations as destination of the supply.

Even though digital goods can be consumed multiple times and at multiple locations and thus do not have a single destination, for the correct application of tax, a place of taxation needs to be determined. There must be mechanisms in place to identify where a transaction takes place and those mechanisms should aim to identify a location where a digital good is most often likely to be consumed. In this context, a question arises whether the use of multiple proxies and presumptions to establish the place of taxation (e.g., place of performance, place of use of enjoyment, customer's residence) is preferable or one simple rule would be sufficient.

In the EU, the place of taxation of electronic services supplied to a non-taxable person should be the place where the customer is established, has his permanent address or usually resides.[53] In order to determine that place, the VAT Implementing Regulation (282/2011) has introduced a number of presumptions, which unfortunately often contradict the main rule rather than clarify its application.[54] For example, for electronic services supplied at a location, such as a Wi-Fi hot spot, an internet café, a restaurant or a hotel lobby, it shall be presumed that the customer is established, has his permanent address or usually resides at the place of that location and that the service is effectively used and enjoyed there.[55] Similarly, for services provided through

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53. Article 58 VAT Directive (2006/112).
54. For a critical evaluation of the presumptions, *see* A.M. Bal, *The Myth of Taxing Cloud Computing under EU VAT*, 25 Intl. VAT Monitor 6 (2014), Journals IBFD.
55. Article 24a VAT Implementing Regulation (282/2011).

### §9.07 FINAL REMARKS

Changes in international taxation that started recently will echo in the years to come. It seems that the focus on collection optimization has eclipsed the discussion regarding the rightful limits of states' taxing powers. On the other hand, one should not forget that debates about the reshaping of the so-called International Tax Regime started with a discussion about precisely what is a country's "fair share of tax."

Current multilateralism was born in the context of struggles for tax revenues. This fact suggests that states engaging in these debates are certainly pursuing an increase in their tax collections. At first glance, it may seem that such tax collection will come from just fighting "aggressive tax planning." However, it is clear that, in some cases, tax collection will result from reshaping the allocation of taxing powers among countries.

Since the dawn of the "International Tax Regime," it is clear that it favors developed countries and reduces the scope of developing countries' taxation powers. However, reviewing the balance between these two groups is not the scope of the BEPS Project or any other international initiative.

It is time for a change. Developing countries should join in the formation of a "Developing Countries' International Tax Regime." Therefore, they should definitely not be too eager to line up in accepting the BEPS Project's recommendations.



CHAPTER 10

# Country-by-Country Over-Reporting? National Sovereignty, International Tax Transparency, and the Inclusive Framework on BEPS

*Romero J.S. Tavares*

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### §10.01 INTRODUCTION

*Dans la nature, rien ne se perd, rien ne se crée, tout se transforme.* Lavoisier's widely known eighteenth century expression of this law of nature also resonates in the global tax policy debate of the twenty-first century – particularly in the area of tax transparency, old ideas and solutions have constantly reappeared.[1] In the decade prior to the launch of the Base Erosion and Profit Shifting (BEPS) Project[2] and even earlier, several initiatives concerning different notions of tax transparency have surfaced, morphed and combined into new domestic laws the world over and into new instruments of public international law.[3] In this new era of tax transparency,[4] BEPS Action 13

1. *See* J. Owens, *Embracing Tax Transparency*, Tax Notes International (2013), pp. 1105–1111.
2. *See* OECD, *Addressing Base Erosion and Profit Shifting*, OECD Publishing (February, 2013) available at http://www.oecd.org/tax/addressing-base-erosion-and-profit-shifting-9789264192744-en.htm, *Action Plan on Base Erosion and Profit Shifting*, OECD Publishing (May, 2013), available at http://www.oecd.org/tax/action-plan-on-base-erosion-and-profit-shifting-9789264202719-en.htm.
3. *See*, e.g., *Multilateral Convention on Administrative Assistance in Tax Matters* and *Multilateral Competent Authority Agreement for the Automatic Exchange of Information (MCAEOI or MCAA-CSR)* available at http://www.oecd.org/tax/automatic-exchange/international-framework-for-the-crs/.
4. *See* M. Lang and P. Haunold, *Transparenz – Eine neue Ära im Steuerrecht*, Linde Verlag (2016).

Deliverables[5] on transfer pricing documentation and their *Country-by-Country Reporting* (hereinafter, CBCR) standard have spurred domestic legislation around the globe: Australia, Canada, Japan, the U.K. and the U.S., all of the European Union (EU), and several other countries initiated the adoption of CBCR,[6] while many more are expected to follow suit.[7]

A fierce debate over whether to make such CBCRs available to the general public still looms in the background[8] and, if unilaterally adopted, might even threaten the global implementation of the new standard or hamper CBCR exchange. Still, rich, poor, high-tax, and low-tax countries alike are all signing into the new international agreements and fully adopting all transparency standards that emerge from Organisation for Economic Co-operation and Development (OECD) initiatives, while taking measures to implement CBCR and all BEPS Action 13 recommendations though domestic legislation, in what may resemble a *stampede effect* – or a *gold rush*. Considering the broader context and dynamics of the tax transparency debate, this global rush towards CBCR raises the question of whether all of the sovereign nations that are endorsing the new standards and adopting CBCR are fully aware of what it entails and what it can realistically achieve in terms of revenues. Most importantly, whether developing countries understand the benefits and burdens to be accrued to their national treasuries stemming from CBCR implementation, in light of the results from BEPS Actions 8–10 in the area of transfer pricing.[9]

5. *See* OECD, *Transfer Pricing Documentation and Country-by-Country Reporting, Action 13 – 2015 Final Report, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing (October 2015) available at http://dx.doi.org/10.1787/9789264241480-en.
6. *See* e.g.: J. Scott Wilkie, *Master File, Local File and Country-by-Country Reporting: A Canadian Perspective*, International Transfer Pricing Journal, IBFD (2016), pp. 115–127; S. Rasch, K. Mank, S. Tomson, *Country-by-Country Reporting*, International Transfer Pricing Journal, IBFD (2016), pp. 147–151; A. Casley, K. Norton and M. Krhoda, *The OECD' s New Transfer Pricing Documentation Standard: An Overview and Possible UK Implementation*, International Transfer Pricing Journal, IBFD (2015), pp. 3–10.
7. *See* e.g.: M.A.P. Valadão, *Transfer Pricing in Brazil and Actions 8, 9, 10 and 13 of the OECD Base Erosion and Profit Shifting Initiative*, Bulletin for International Taxation, IBFD (2016); R.J.S. Tavares and J. Owens, *Global Tax Policy Post-BEPS and the Perils of the Silk Road*, 22 Asia Pacific Tax Bulletin 4, IBFD (2016); R.J.S. Tavares and A. Dias, *What Will a Post-BEPS Latin America Look Like?*, Tax Notes International (2016), pp. 551–561; and R.J.S. Tavares and J. Owens, *BEPS Implementation in Eastern Europe and Central Asia: A Status Report*, World Bank Group (forthcoming, 2017).
8. *See* R. Finley, *German Tax Head Supports Joint Audits, But Not Public CbC Reporting*, Tax Notes International (2016) at 847; R. Finley, *NGOs Urge Treasury, IRS to Make CbC Reports Public*, Tax Notes International (2016), pp. 765–766; M. Herzfeld, *Tax Transparency Is in The Eye of the Beholder*, Tax Notes International (2016), pp. 647–650; R. Finley, Treasury, *NGOs Differ on Purpose of CbC Reporting Data*, Tax Notes International (2016), pp. 384–385; R. Goulder, *NGOs Push G-20 for Country-by-Country Reporting*, Tax Notes International (2011), pp. 451–454.
9. OECD, *Aligning Transfer Pricing Outcomes with Value Creation, Actions 8-10 – 2015 Final Reports, OECD/G20 Base Erosion and Profit Shifting Project*, OECD Publishing, Paris (October 2015) available at http://dx.doi.org/10.1787/9789264241244-en. *See also*, M.T. Evers, I. Meier and C. Spengel, *Transparency in Financial Reporting: Is Country-by-Country Reporting Suitable To*





One cannot help but wonder whether the revenue gains from CBCR are expected to be material and to outweigh implementation costs comparably or proportionately in all countries. Or whether, particularly in developing countries, other resource mobilization options and policy choices would be money better spent, yielding higher returns on the investment of public resources or otherwise producing greater positive effects in-country. Indeed, a question must be raised as to whether a nuanced, *bottom-up* analysis of all outcomes of the BEPS Project and related policy design options would be warranted for developing countries prior to any implementation action.[10] If so, then the so-called *Inclusive Framework* promoted by the OECD and the G20 for implementation of the complete BEPS package as it stands,[11] with an emphasis on CBCR amongst its minimum standards and within the framework of recommendations arising from BEPS Actions 8–10 (and not beyond them), could be viewed as a rushed approach, as it may disproportionately burden developing countries.

Since BEPS Actions 8–10 still did not break away from the Arm's Length Principle (ALP), some tax activists might even view the Inclusive Framework as *marching orders*

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*Combat International Profit Shifting?*, Bulletin for International Taxation, IBFD (2014), pp. 295–303. *See yet again*, R. Finley, *Countering Base Erosion Is Impossible within Current System, Panel Says*, Tax Notes International (2016), pp. 847–848. For a critical view of the shortcomings of the ALP which remain even post-BEPS, *see* e.g.: Y. Brauner, *BEPS: An Interim Evaluation*, 6 World Tax Journal, n. 1 (2014), Journals IBFD; R. Avi-Yonah, *The Rise and Fall of Arm's Length: a study in the Evolution of United States International Taxation*, 15 Virginia Tax Review 89 (1995); Y. Brauner, *Value in the Eye of the Beholder: The Valuation of Intangibles for Transfer Pricing Purposes*, 28 Virginia Tax Review 79 (2008); J. Clifton Fleming, R. Peroni and S. Shay, *Formulary Apportionment in the U.S. International Income Tax System: Putting Lipstick on a Pig?*, 36 Michigan Journal International Law 1 (2015); R. J. Vann, *Taxing International Business Income: Hard-Boiled Wonderland and the End of the World*, World Tax Journal, IBFD (2010), pp. 291–346; M.A. Kane, *Transfer Pricing, Integration and Synergy Intangibles: A Consensus Approach to the Arm's Length Standard*, World Tax Journal, IBFD (2014), pp. 282–314; R.J.S. Tavares, *Multinational Firm Theory and International Tax Law: Seeking Coherence*, 8 World Tax Journal 2, IBFD (2016).

10. *See* M. Durst, *Self-Help and Altruism – Protecting Developing Countries' Tax Revenues*, in T. Pogge and K. Mehta, *Global Tax Fairness* (Eds.), Oxford (2014), pp. 316–338. *See also*, Durst, *Limitations of the BEPS Reforms: Looking Beyond Corporate Taxation for Revenue Gains*, ICTD Working Paper 40 (2015); *and*, M. Durst, *Beyond BEPS: A Tax Policy Agenda for Developing Countries*, ICTD Working Paper 18 (2014).
11. The official position of the OECD is that the BEPS Project "included" over 80 developing countries, and the initiative to support a consistent launch and worldwide implementation of deliverables referred to as the "inclusive framework" already includes over 100 countries. In fact, these countries exerted little to no influence in the technical and political debate, which was very much amongst the G20. *See*, OECD, About BEPS and the inclusive framework, available at http://www.oecd.org/tax/beps/beps-about.htm, which states: *"The inclusive framework brings together over 100 countries and jurisdictions to collaborate on the implementation of the OECD/G20 Base Erosion and Profit Shifting (BEPS) Package. (...) Developing countries have been engaged since the beginning of the BEPS Project. Over 80 developing countries and other non-OECD/non-G20 economies discuss the challenges of BEPS through direct participation in the Committee on Fiscal Affairs, regional meetings in partnership with regional tax organisations, and thematic global fora. Many developing countries are now joining the inclusive framework."*

*from the north*[12] seeking to prevent the development of alternative transfer pricing standards, under the cloak of an "inclusiveness" misnomer – the ALP with CBCR would be no more than a wolf in sheep's clothes. Many activists might view it instead as a half-win,[13] as a first step towards global formulary apportionment (GFA). This study suggests that it is likely neither.

This chapter explores whether implementing the CBCR standard, without a deeper transfer pricing reform, should be viewed as a priority in every country, and worthy of mobilization of the scarce resources of developing countries. It addresses the question of whether all countries that are contemplating implementation of CBCR are fully aware of its revenue potential, and whether all countries see the implementation of CBCR in the context of a broader debate of transfer pricing standards, as one more episode in the conceptual battle of GFA versus the ALP. The author posits that CBCR might indeed be useful to curb transfer mispricing; however it will not serve to combat tax avoidance achieved through ALP-compliant transfer pricing, which enables non-taxation of substantial intangible-related residual profits within multinational enterprises (MNEs).[14] Furthermore, it may a redundant tool, in light of the new and widespread standards that arise from the *Global Forum on Tax Transparency and Information Exchange* (hereinafter, "the Global Forum").[15]

In this sense, this study acknowledges that CBCR would serve to compare and contrast hypothetical GFA versus ALP results, and thus to stir the debate of transfer pricing reform within the OECD, and amongst developed economies and the G20. Nonetheless, it questions whether the aforementioned transfer pricing debate requires public disclosure of taxpayer-specific CBCR filings, and whether investing now in CBCR and in the ALP versus GFA debate is opportune for developing countries.

12. On the relevance of tax activists in the development of global tax policy and tax transparency, *see* A. Christians, *Tax Activists and the Global Movement for Development Through Transparency*, in Y. Brauner and M. Stewart (Eds.), *Tax Law and Development*, Edward Elgar Publishing Ltd. (2013), pp. 288–315. *See also*, Owens, *supra* n. 1 at 1106, and *infra* n. 49. Since the final deliverables, minimum standards and recommendations arising from BEPS represent the outcome of bargaining between some OECD Member States and the G20 (particularly China and India, and, to a lesser extent, Brazil) wherein the U.S. (the "north") and the EU seems to have prevailed. This bargaining dynamics has not effectively included developing countries, hence the policies that result may be viewed to lack legitimacy. For an overview of the jurisprudential issue of legitimacy as it pertains to international taxation, *see* e.g., A. Christians, *Sovereignty, Taxation and Social Contract*, 18 Minnesota Journal International Law (2009).
13. *See* R. Goulder (2011), *supra* n. 8, at 453: *"So what do the NGOs want? Formulary apportionment might be their ultimate objective, but they'd settle for a half-step. They're calling on G-20 leaders to urge the International Accounting Standards Board to implement mandatory CBCR."*
14. *See* Tavares & Owens, *Human Capital in Value Creation and Post-BEPS Tax Policy: An Outlook*, 69 Bulletin International Taxation 10, IBFD (2015). *See also* Tavares & Owens (2016), *supra* n. 7. *See yet again*, Tavares (2016), *supra* n. 9.
15. *See*, OECD Website at http://www.oecd.org/tax/transparency/about-the-global-forum/.





## §10.02 THE PRE-BEPS TAX TRANSPARENCY GAME:[16] COMPETITION OR REFORM?

### [A] Defining Tax Transparency

In order for countries to understand their rules of engagement on international tax transparency, and what is at stake for their national treasuries, first it is necessary to define what tax transparency means.[17] Different meanings stem from different relationships and interactions between the persons from whom information disclosure is required, and by whom information will be used. The object and purpose of rules governing these different situations is varied. Tax transparency can mean the disclosure of taxpayer information to tax authorities, the transparency of tax authorities to taxpayers or to other tax authorities, or the transparency of taxpayers and tax authorities to the general public. Nonetheless, these different dimensions of tax transparency are also interrelated and, thus, are often intertwined in legislation.

The first and most intuitive notion is that taxpayer information must be disclosed to government authorities, i.e., taxpayers must be transparent to the taxing authorities governing them.[18] Taxpayers' rights would be safeguarded by the rule of law, including

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16. Over the years, a significant trend of interdisciplinary research emerged bringing mathematics, economics and social relations together, whereby "cooperative game theory" (rooted on J. Nash), and bargaining theory (developed by O. Hart), has been widely applied in the study of economic relations and international taxation. This trend has crossed over into the field of international trade law and international tax law. *See* e.g., T. Dagan, *The Tax Treaties Myth*, 32 N.Y.U. Journal of International Law and Politics 939 (2000), who draws on game theory to argue that an unfair transfer of wealth from poorer to richer countries results from tax treaties. *See also*, R. Chisik and R.B. Davies, *Asymmetric FDI and tax-treaty bargaining: theory and evidence*, Journal of Public Economics 88 (2004), pp. 1119–1148; and *Gradualism in Tax Treaties with Irreversible Foreign Direct Investment*, International Economic Review 45, pp. 113–139; *see yet again*, R.B. Davies, *The OECD Model Tax Treaty: Tax Competition and Two-Way Capital Flows*, International Economic Review 44, pp. 725–753; *and*, R.B. Davies, *Tax Treaties, Renegotiations, and Foreign Direct Investment*, Economic Analysis and Policy 33, pp. 251–273. Christians (2009), *supra* n. 12, at 102, also finds relevance in such alternative streams of research, stating: *"The approach of this article is by no means the only analytical framework for examining the OECD as an institution and its influence on national law in the U.S. and elsewhere. The same issues could also be analyzed from a law and economics, utilitarian, game theoretic or international relations approach, among others. See Allison Christians, Steven Dean, Diane Ring & Adam H. Rosenzweig, Taxation as a Global Socio-Legal Phenomenon, 14 ILSA J. INT'L & COMP. L. 303, 306 (2008) (arguing that more analysis of tax policy from these various lines of inquiry would help clarify the role of law in regulating global economic activity)."*
17. *See* Owens, *supra* n. 1 at 1105.
18. *Id.*, at 1105: *"The OECD has for several years been focused on transparency, particularly in its initiatives to counter offshore noncompliance, by requiring and seeking new tools for tax authorities to know the full position of taxpayers, including the ultimate ownership of relevant income and assets. This transparency concept includes the tax authorities knowing all the entities within a country that are controlled by a taxpayer. This form of transparency has broadened in recent years as tax authorities realized that they do not understand fully the profile of the MNE across its global activities, especially when they involve overseas entities affiliated with their domestic taxpayer that are located in low-tax countries. This type of transparency has been enhanced by new initiatives such as more focused reporting requirements related to aggressive tax planning and uncertain tax issues. So the tax authorities are seeking more information about taxpayers' affairs by their greater willingness to challenge more risky issues, those with greater*

a fundamental right to due process, and in most countries a right to tax confidentiality which safeguards the freedom of enterprise.[19] A second notion is a mirror image of the first, and it is grounded on economic psychology studies on tax compliance:[20] governments should be transparent to taxpayers, both in their rule-making processes as well as in the prevention and resolution of disputes.[21] A third perspective coherently

*potential for tax controversy. This involves initiatives such as Australia's pilot on reportable tax positions, the U.K.'s reporting of aggressive tax 'schemes,' and the U.S.'s disclosures of uncertain tax positions."*

19. The fundamental freedom to conduct a business derives from the human rights to ownership, privacy, association, and self-determination. *See* UN General Assembly, *Resolution 2200A (XXI)* of 16 December 1966 (entry into force 23 March 1976), International Covenant on Civil and Political Rights, Article 1, which states: "*1. All peoples have the right of self-determination. By virtue of that right they freely determine their political status and freely pursue their economic, social and cultural development. 2. All peoples may, for their own ends, freely dispose of their natural wealth and resources without prejudice to any obligations arising out of international economic co-operation, based upon the principle of mutual benefit, and international law. In no case may a people be deprived of its own means of subsistence. 3. The States Parties to the present Covenant, including those having responsibility for the administration of Non-Self-Governing and Trust Territories, shall promote the realization of the right of self-determination, and shall respect that right, in conformity with the provisions of the Charter of the United Nations." See also,* EU *Charter of Fundamental Rights*, Article 16: *"The freedom to conduct a business in accordance with Community law and national laws and practices is recognised"* and Commentary: *"This Article is based on Court of Justice case-law which has recognised freedom to exercise an economic or commercial activity (see judgments of 14 May 1974, Case 4/73 Nold [1974] ECR 491, paragraph 14 of the grounds, and of 27 September 1979, Case 230-78 SpA Eridiana and others [1979] ECR 2749, paragraphs 20 and 31 of the grounds) and freedom of contract (see inter alia Sukkerfabriken Nykøbing judgment, Case 151/78 [1979] ECR 1, paragraph 19 of the grounds, and judgment of 5 October 1999, C-240/97 Spain v. Commission [1999] ECR I-6571, paragraph 99 of the grounds) and Article 119(1) and (3) of the Treaty on the Functioning of the European Union, which recognises free competition. Of course, this right is to be exercised with respect for Union law and national legislation. It may be subject to the limitations provided for in Article 52(1) of the Charter."*
20. Economic psychology studies grounded on Kirschler, Hoezl & Wahl (2008) support that increasing taxpayer morale not only has a state-building feature but also increases tax compliance and revenues, and that a balance must be struck between enforced and voluntary compliance (the so-called slippery slope framework). This theory and approach motivated the widespread adoption of "cooperative compliance"-type programs throughout the world (e.g., horizontal monitoring in the Netherlands, enhanced relations in the U.K., compliance assurance process in the U.S.) and other "service"-driven initiatives within tax administrations worldwide (e.g., U.S. taxpayers's advocate, small-business or large taxpayer offices, etc.). *See*, E. Kirchler, E. Hoelzl and I. Wahl, *Enforced Versus Voluntary Tax Compliance: The "Slippery Slope" Framework*, 29 Journal of Economic Psychology 2 (2008), pp. 210–225; E. Kirchler, S. Muehlbacher, B. Kastlunger and I. Wahl, *Why Pay Taxes? A Review of Tax Compliance Decisions*, in J. Alm, J. Martinez-Vazquez, and B. Torgler (Eds.), *Developing Alternative Frameworks for Explaining Tax Compliance*, Oxon: Routledge (2010), pp. 15–31; S. Muehlbacher, E. Kirchler and H. Schwarzenberger, *Voluntary Versus Enforced Tax Compliance: Empirical Evidence for the "Slippery Slope" Framework*, 32 European Journal of Law and Economics 1, (2011), pp. 89–97 *available at* https://doi.org/10.1007/s10657-011-9236-9; J. Alm, E. Kirchler and S. Muehlbacher, *Combining Psychology and Economics in the Analysis of Compliance: From Enforcement to Cooperation*, 42 Economic Analysis & Policy 2, (2012), pp. 133–151. The fairness debate fits into this utilitarian view of taxpayer morale (i.e., increased compliance) whilst it also fits into a broader state-building framework, of enhanced democracy, individual liberties, and national sovereignty.
21. Transparency in rule making and in the resolution of disputes (i.e., due process) are fundamental features of the democratic rule of law. These characteristics of a nation and tax system are telling of the quality of human rights in any given country, as much as of its investment climate.





binds the first two together in a global economy: tax authorities must be transparent with one another, share information, and cooperate, and thus collectively uphold the rule of law. The normative construct of this third notion imposes that governments should be transparent to other governments concerning taxation, thus not only enabling tax enforcement but curbing *harmful tax competition*.

### [B] Tax Transparency and Tax Competition: Harm as a Matter of Law

Some economic debate exists as to whether the so-called race to the bottom and erosion of the corporate tax associated with the use of "tax havens" would lead to inequality and the collapse of states or whether it would be conducive to economic growth and global welfare.[22] Irrespective of such matter of fact, jurisprudential thought would posit

*See* J. Owens, *Tax Policy in the 21st Century: New Concepts for Old Problems*, European University Institute., Issue 2013/05 – Global Governance Program, Robert Schuman Ctr Advanced Stud. (2013). *See also*, J. Owens, *The Role of Tax Administrators in the Current Political Climate*, 67 Bulletin for International Taxation 3, IBFD (2013), at p. 160, stating that: *"[t]oday, tax administrations and taxpayers increasingly recognize that they have a shared interest in minimizing and quickly resolving tax disputes and a recognition that this requires focussing not just on one particular issue, but on the whole process by which they can avoid disputes. This requires engaging taxpayers in the process of policy formulation and implementation. It requires identifying and discussing issues before they become problems. It requires pre-filing resolutions, the type of programmes that we see in the United States (the compliance assurance program (CAP)) or the Netherlands' horizontal monitoring programmes. It also requires a greater use of informal mediation, particularly in the area of establishing the facts in transfer pricing cases. And it requires a wider use of advance pricing agreement (APA) type of programmes and mandatory arbitration. All of this will require a new type of commitment from tax administrations and a willingness to devote scarce and highly trained officials to resolve tax disputes." See yet again* OECD, *Co-operative Compliance: A Framework: From Enhanced Relationship to Co-operative Compliance* (OECD 2013) [hereinafter the "Cooperative Compliance Report (2013)." The tax compliance framework of "TCF," as illustrated in Cooperative Compliance Report (2013), *supra*, at pp. 57–63 provides an adequate approach through which to pursue such goals. The TCF is based on the "OECD Guidelines for Multinational Enterprises," first adopted in 1976 and reviewed five times through to 2011 as part of the OECD, *Declaration and Decisions on International Investment and Multinational Enterprises* (OECD 2011) and is coherent with the *OECD Declaration on Propriety, Integrity and Transparency in the Conduct of International Business and Finance* (OECD 2010). Only if all these statements and reports by the OECD are taken as a coherent whole, interpreted and applied systematically and used as a *context* within which any international tax rules, any guidelines or commentaries by the OECD are used, would the international tax system promoted by the OECD make sense. It would be grounded on "cooperation and ethics," rather than "competition and harm" – hence coherent with the object and purpose of the OECD itself, as per its Charter. *See*, *Convention on the Organisation of Economic Co-operation and Development* (Paris, 1960), Articles 1, 2 and 3, *available at* http://www.oecd.org/general/conventionontheorganisationforeconomicco-operationanddevelopment.htm; the OECD Convention replaced the 1948 Charter of the *Organisation for European Economic Co-operation* (OEEC) developed under the Marshall Plan.

22. K. Vogel, *Worldwide vs. Source Taxation of Income – A Review and Re-evaluation of Arguments (Part I)*, Intertax 8-9, pp. 216–219 (1988) at 216 et seq., references the long-standing U.S. tradition under which the international allocation of taxing rights should favor residence countries, and sees it to be rooted in the theories famously developed by U.S. economists Richard P. Musgrave and Peggy Richman (Peggy Musgrave). Vogel cites to the Musgraves' very influential publications of 1960, 1963, 1965, 1969, 1972 and 1974. Other U.S. economists continued to develop and support the same theory which favors residence countries and the low-taxation of capital. *See* e.g., J.R. Hines, E.M. Rice, *Fiscal Paradise: Foreign Tax Havens and*



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that certain modes of tax competition might be defined as unlawful delicts under international law. Unsanctioned delicts would subvert the rule of law and would therefore be "inherently harmful" as a matter of law.

From a tax policy perspective, this critical issue has been debated *ad nauseam*. The 1998 OECD Report on Harmful Tax Competition[23] acknowledged and exposed the factual problem, motivating the inception of the *Global Forum* in 2000, which remains as one of the most successful initiatives ever carried out under the auspices of the OECD.[24] Tax competition would be defined as "harmful," and thus unlawful, only when countries are uncooperative, secretive, *and* when their regimes are designed to distort investment and/or trade flows between other countries. The difficulty here is that "one nation's harmful tax regime is another state's competitive tax policy"[25] – as such, where should international law draw the line? To illustrate the factual problem addressed by the Global Forum, and to apply a framework of analysis grounded on jurisprudential thought, let us use a hypothetical example:

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*American Business*, Quarterly Journal of Economics 109 (1), (1994), pp. 149–182; J.R. Hines, *Altered States: Taxes and the Location of Foreign Direct Investment in America*, American Economic Review 86 (5) (1996), pp. 1076–1094; J.R. Hines, *Tax Policy and the Activities of Multinational Corporations* in A.J. Auerbach (Ed.), *Fiscal Policy: Lessons from Economic Research*, MIT Press, Cambridge, (1997), pp. 401–445; J.R. Hines, *Lessons from Behavioral Responses to International Taxation*, National Tax Journal 52 (2), (1999), pp. 305–322; M.A. Desai, C. Fritz Foley, and J. Hines Jr., *Domestic Effects of the Foreign Activities of US Multinationals*, American Economic Journal: Economic Policy, 1:1 (2009), at pp. 181–203. Unsurprisingly, many U.S. tax legal scholars will tend to follow to the rationale developed in this string of economic literature. *See* D.N. Shaviro, *Fixing U.S. International Taxation*, Oxford University Press (2014). *See also* e.g., Fleming, Peroni & Shay, *Getting Serious About Curtailing Deferral of U.S. Tax on Foreign Source Income*, SMU Law Review 455 (1999), *Fairness in International Taxation: The Ability-to-Pay Case for Taxing Worldwide Income*, 5 Florida Tax Review 4 (2001), *Designing a U.S. Exemption System for Foreign Income When the Treasury is Empty*, 13 Florida Tax Review 8 (2012). Across the Atlantic, proponents of a consumption-based corporate income tax, or of a so-called optimum corporate tax (which could exempt capital and the financial services sector that flourishes in London and Luxembourg) follow a similar efficiency-seeking rationale. *See* e.g., R.A. Mooij, and M.P. Devereux, *Alternative Systems of Business Tax in Europe: An Applied Analysis of ACE and CBIT Reforms*, Taxud Taxation Papers, European Union (2009).

23. *See*, OECD, *Harmful Tax Competition – An Emerging Global Issue* Paris (1998), *available at* https://www.oecd.org/tax/transparency/44430243.pdf.
24. *See*, OECD *supra* n. 15.
25. *See* Owens, *supra* n. 1 at 1106: *"Preferential harmful tax regimes have been on both the EU and OECD agendas for some time. This is a complex area. One nation's harmful tax regime is another state's competitive tax policy. (…) The European Commission has become very active in this area. It's going to be hard for either the European Commission or the OECD to shift this debate beyond clear cases of harmful tax practices. BEPS action 5 suggests there is little political will to extend the definition of harmful. It can be expected that work in this area will focus on transparency and information exchange. The action plan, for example, calls for more transparency and the spontaneous exchange of information on rulings related to preferential tax regimes. The EU meanwhile links harmful tax practice identification and its code of conduct to issues of tax rate, substance, and nondiscrimination. Whether an OECD consensus on the definition of harmful tax practices could extend as far as the EU code of conduct remains to be seen. However, the BEPS report does call for a focus on substance requirements for any preferential tax regime (something already foreseen in the 1998 report on harmful tax competition), and it seems likely that the conditions of the EU code of conduct will inform the debate."*





Suppose a resident of Home State A intends to invest in Host State B, and that a bilateral tax treaty between Country A and Country B limits withholding tax rates on interest and on royalties at 5%. Suppose Country B has entered into a bilateral tax treaty with Country C, under which no withholding taxes can be imposed, and that a similar treaty exists between A and C. Further, suppose Home Country A does not have effective "controlled foreign company" (hereinafter CFC) rules, and that the A-B, B-C, and A-C tax treaties do not have any form of anti-abuse rule [i.e., no limitation on benefits (LOB) clause, no principal purpose test (PPT)]. Suppose these treaties are old and were entered into at a time predating advances in information and communication technologies (ICT) that now enable MNEs to vertically integrate operations and treasuries.[26] This scenario could be observed in many if not most of the more than 3,000 tax treaties that exist today.

Now, suppose that many years after the A-B, B-C and A-C tax treaties come into force, and whether or not through legislation, regulations, or private rulings, Country C starts to grant ring-fenced tax incentives, exempting from corporate income tax and from withholding tax certain categories of income (e.g., interest, royalties) and even active trade and business income earned from foreign sources, or from exports. Non-taxation at Country C could also materialize, for instance, if income is earned through an entity incorporated therein but managed and controlled abroad. From Country C's perspective, the tax exemptions would be permanent if untaxed earnings are distributed to owners that are not residents of Country C.

The unilateral actions of Country C, therefore, would interfere with investments flowing from Country A to Country B, yet without placing Country C in direct competition against Country B as a final Host State. Rather, investors from Home State A would be tempted to simply *route investments through* a legal entity incorporated in Country C, and *not* to invest in Country C *instead of* Host State B. By positioning itself as an intermediary and not as a substitute, Country C would be *deliberately intervening* in the economic relations of Countries A and B, availing a triangular legal structure for investors to execute what essentially remains a bilateral capital flow from Home State A into Host State B. And it can be said that Country C's intervention would adversely affect or harm[27] the national treasuries of A and B.

To better demonstrate the problem, suppose the investment climate in Country C is no better than the investment climate in Countries A and B (i.e., sovereign risk, institutional risks, rule of law, currency issues are all equivalent in A, B, and C), and that there are no other non-tax reasons to justify the aforementioned triangular structure. Country C would position itself as an "investment platform" or "hub" seeking to intermediate investment and trade flows that would otherwise be distributed between A and B only, and that remain originating in A and destined to B. Thus,

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26. *See supra* n. 14.
27. For an enlightened discussion of the "duty not to harm," *see* R.A. Rodrigues, *Inter-Nation Equity as a Limit for Tax Policy* (forthcoming, 2017).



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from a jurisprudential perspective it can be said that Country C's positioning would subvert the bilateral context of tax treaties by undermining the A-B bilateral tax treaty and enabling the multilateral use of A-C and B-C bilateral tax treaties. Home State A taxation would be deferred through this scheme (while earnings are accumulated by a legal entity incorporated in Country C and not distributed as dividends); whereas Host State B taxation would be reduced by the interposition of Country C between A and B and application of the B-C tax treaty.

Moreover, the structure would be *self-serving* as it would result in cash accumulation at Country C, including residual income from intra-group trade,[28] inflated by the amounts of A and B taxes formally avoided, while such accumulation of cash at Country C would require some minimum level of activity to be carried on at Country C. Note, any and all tax revenues collected to the treasury of Country C (irrespective of any exemptions granted by C), would be inherently incremental to Country C, and be diverted from Countries A and B – meaning that no tax subsidies or financial aid would burden the treasury of Country C.[29] The accumulation of capital in Country C, along with the performance of activities resulting from the interposition of C between A and B, would produce indicators of "legal substance"[30] (cash, activities diverted from countries A and B, capital assets including the legal ownership of intangible property), which would in turn allegedly justify the structure.[31] This diversion of activities, intangibles, and cash could also have real distortionary effects,[32] i.e., it could lead to economic inefficiencies detrimental to the welfare of the conjunction of countries A, B, and C. Adding insult to injury, suppose the competent authorities of Country C do not respond to information requests from A or B, do not disclose any information pertaining to the legal entity located in C which earns interest and royalty income from B, or any details concerning the operation of its ring-fenced tax incentives.

Building on the notions established in the 1998 Report and through the Global Forum, countries have effectively *outlawed* the aforementioned mode of tax competition, by defining it as "harmful." From a legitimacy perspective, it should be noted that the Global Forum is a particularly remarkable institution as it congregates states that

28. *See supra* n. 9.
29. If Country C were an EU Member State, the fact that this hypothesized "harmful tax competition" scheme would not represent any real onus to the treasury of Country C, but only to the treasuries of Countries A and B and in spite of the apparent "incentive" granted by C, would possibly represent an infraction by Country C to the EU Code of Conduct, but not configure the concession of "State Aid" by Country C. *See*, R.J.S. Tavares, B.N. Bogenschneider and M. Pankiv, *The Intersection of EU State Aid and U.S. Tax Deferral: A Spectacle of Fireworks, Smoke, and Mirrors*, 19 Florida Tax Review 3 (2016).
30. *See* Tavares (2016), *supra* n. 9. *See also*, Tavares, *The "Active Trade or Business" Exception of the Limitation on Benefits Clause*, in M. Lang et al. (Eds.), *Base Erosion and Profit Shifting: The Proposals to Revise the OECD Model Convention*, Linde Verlag (2016).
31. *Id.*
32. Even though some academic and political debate still exists as to whether the tax avoidance effects of such triangular structures are indeed damaging to global economic welfare, to Home State A, or to Host State B. *See supra* n. 22.





are not members of the OECD along with OECD Members "on an equal footing"[33] and under a common cause. It enables the global coordination of key aspects of national tax policies, and it establishes the circumstances in which one country's policy can be deemed harmful against other countries, reaching far beyond the jurisdictions of OECD Members. As such, the success of the Global Forum can also be explained from a jurisprudential perspective.[34]

Opaque and distortive tax policies adopted by one state that are designed to interfere with investment and trade flows between two other states, formally forcing upon such states a set of legal rules which would limit their taxing jurisdictions, carried on under the cloak of secrecy by uncooperative states, may be viewed as not only contrary to the legal principle of good-faith but also as an *unlawful intervention* under general international law (*jus cogens*).[35] The state that engages in such mode of unlawful tax competition would infringe upon the sovereign rights of the states that have their national treasuries harmed by the improper use of bilateral tax treaties and/or by the aiding and abetting of tax evaders.[36] Accordingly, the international community would be justified to react, and to *impose sanctions* on states which perpetrate such unlawful intervention.

The institution of the Global Forum and its *Multilateral Convention on the Mutual Administrative Assistance in Tax Matters* (hereinafter "the Multilateral Convention") and related instruments which tackle uncooperative jurisdictions,[37] function as a

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33. *See*, OECD *supra* n. 15 which states that *"[t]he Global Forum currently has 137 members participating on an equal footing, together with 15 international organisations participating as observers."*
34. Christians (2009), *supra* n. 12, analyzed this issue not by referencing international law, but instead through political philosophy and Anglo-American jurisprudence. Christians contrasting a Rawlsian "social contract" view of fiscal sovereignty with "rights-based" analysis under Nussbaum's cosmopolitanism. Christians acknowledges, however, that a jurisprudential analysis grounded on international law can be feasible to understand and interpret this matter. Her review of Anglo-American jurisprudential theories leading to cosmopolitanism seems to further reinforce that even in the Anglo-American juridical tradition there would be a sociological context or rights-based imperative which would justify and requires the enforcement of international law. International legal scholars would reach a similar conclusion, yet using a sanctions-based approach. *See* e.g., H. Kelsen, *Pure Theory of Law*, translation from the second (revised and enlarged) German edition by Max Knight, University of California Press (1989), pp. 279–347.
35. *See supra* n. 19. *See also* Kelsen, *supra* n. 34.
36. Be it through transfer mispricing and tax avoidance, or through tax evasion, money laundering and the sheltering of other illicit activities. This is at the core of Panama Papers and LuxLeaks scandals – nonetheless illicit activities are but one facet of the problem. A much wider equation would encompass aggressive tax planning and avoidance which is still deemed to be legitimate.
37. *See supra* n. 3: *"the Convention on Mutual Administrative Assistance in Tax Matters ('the Convention') was developed jointly by the OECD and the Council of Europe in 1988 and amended by Protocol in 2010. The Convention is the most comprehensive multilateral instrument available for all forms of tax co-operation to tackle tax evasion and avoidance, a top priority for all countries. The Convention was amended to respond to the call of the G20 at its 2009 London Summit to align it to the international standard on exchange of information on request and to open it to all countries, in particular to ensure that developing countries could benefit from the new more transparent environment. The amended Convention was opened for signature on 1 June 2011. Since 2009, the G20 has consistently encouraged countries to sign the Convention including most recently at the meeting of the G20 Finance Ministers and Central Bank Governors Meeting in February 2016 where the communique stated 'We reiterate our call for all countries to*

formal expression of such legal dynamics and of the prevailing force of international law. By setting standards and monitoring states through *peer reviews*, the Global Forum formally recognizes the conditions in which sanctions against noncompliant states are legitimized.

Using our earlier example, the unilateral actions of Country C may not only be deemed to breach the B-C and A-C tax treaties (which in good-faith were meant to be bilateral and to serve as instruments of mutual assistance). Country C's unilateral policies, secrecy, and uncooperative stance, could be viewed as an unlawful economic intervention which harms the national treasuries of A and B, and, as such, acts of aggression against nations A and B. Any tax revenues collected by Country C would be incremental to C and could be viewed as the spoils of *raids* by C against the treasuries of A and B. Through this reasoning, C's tax policies would be an infringement to the sovereign rights of self-determination of A and B, under general norms international law.

If unsanctioned, these so-defined *harmful* tax policies adopted by uncooperative states would subvert the rule of international law, by undermining the sovereign rights of the offended states. Accordingly, countries that reject the Global Forum and the Multilateral Convention, or that fail to demonstrate *through peer reviews* that their unilateral tax policies are not harmful, would not only become pariahs in the international concert of nations; proportionate retaliatory measures adopted against these rogue states would be viewed as *lawful sanctions* from the viewpoint of international law jurisprudence.

Lawful sanctions could take the form of unilateral or multilateral measures, ranging from higher withholding tax rates, special excise taxes or countervailing duties on transactions involving the offending country,[38] or even the termination of treaties and the cessation of financial aid. If materialized, these sanctions could cause significant hardship to the country that adopts a unilateral policy that is deemed harmful to others. From a jurisprudential perspective, the threat of such sanctions would not only discourage *but effectively coerce* all countries to cooperate, forcing all states not to harm one another through predatory tax policies, and thus to abide by general rules of international law.[39]

Therefore, it is no wonder that no less than 137 countries have joined the Global Forum and 107 countries signed the Multilateral Convention and committed to *Exchange of Information upon Request* (EOIR) and to *Spontaneous Exchange of*

*join the Multilateral Convention on Mutual Administrative Assistance in Tax Matters [...]' 107 jurisdictions currently participate in the Convention, including 15 jurisdictions covered by territorial extension. This represents a wide range of countries including all G20 countries, all BRIICS, all OECD countries, major financial centres and an increasing number of developing countries."*

38. Unilateral measures are often adopted and perceived as legitimate under international law. The listing of tax haven that are subject to such defensive measures is a common practice, and have been widely adopted throughout Europe, and Latin America, for example.
39. *See* Kelsen, *supra* n. 34.





*Information* (SEOI), while 87 have committed to *Automatic Exchange of Information* (AEOI)[40] under the Multilateral Competent Authority Agreement (MCAA) through the Common Reporting Standard (CSR). And these numbers keep growing. By 2018 all signatory countries will be fully engaged and operating EOIR and/or AEOI, subject to *peer reviews* under the monitoring of the Global Forum.

### [C] Tax Transparency and the General Public

Another dimension of tax transparency concerns the right of the general public to have access to information pertaining to the relationship between taxpayers and governments. Here, the goal would be twofold: (a) to prevent the unlawful conduct of government officials (e.g., corruption, granting of illegal subsidies, etc.);[41] and (b) to inform the general public about complex aspects of the tax laws of their countries, enabling the engagement of the public in the debate of legislative reform.[42]

Well-educated and well-informed citizens, with freedom of speech and with other civil liberties such as freedom of association, freedom of enterprise, and a free press, are the cornerstones of any democracy. Individual freedoms and civil liberties, nonetheless, are only guaranteed in any state if subjected to the rule of law, which is operated through the constituted governments of any such democratic state. In jurisprudential theory, it is the democratic rule of law that guarantees both individual liberties and national sovereignty, as both are recognized and safeguarded by international law.[43] Any legislative debate or institutional reform conducted under this framework would be state-building, leading to the full exercise of civil liberties and national sovereignty. The tax transparency debate must also be conducted without

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40. *See*, OECD *supra n. 15* which states that *"All member jurisdictions have committed to implementing the international standard on EOIR. The Global Forum conducts rigorous assessments of compliance with this standard, according to the elements set out in its Terms of Reference. In addition, more than 90 countries and jurisdictions have committed to implementing the new standard on AEOI. Work is currently underway to implement this Standard, with the first exchanges occurring on a very ambitious timeline of 2017 and 2018. The implementation of these international standards significantly contributes to the fight against tax evasion, as well as achieving greater international co-operation and enhanced transparency of corporate bodies, arrangements and financial information."*
41. *See* Owens, *supra* n. 1 at 1106: *"There has been growing awareness in many developing countries that the taxes and charges paid by MNEs have in part been taken by politicians and other intermediaries for their private and political purposes. This led to the development of the Extractive Industries Transparency Initiative (EITI), which involves MNEs making public disclosures of their operations in various countries, including payments made to foreign governments. These disclosures enhance the probity and governance of countries in which the MNEs operate."*
42. *Id.*, at 1105, noting the use of public disclosure within the European Union (in respect to extractives and forestry), and beyond: *"Not all developments in this area have been multilateral; some have been purely national. In Australia, for example, the Taxation Office is required to publicly disclose, in relation to companies and corporate tax entities generating more than AUD 100 million in gross income per year, taxpayers' gross income, taxable income, and taxes paid. Australia and Denmark are the only countries to require such widespread public disclosure by all companies."*
43. *See* Kelsen, *supra* n. 34.